Case No. D20/02

Profits tax – whether profits are wholly derived outside Hong Kong – whether profits are derived partly from outside Hong Kong and be apportioned in that only those profits which are derived in Hong Kong should be taxed – the broad guiding principle is that one should look to see what the taxpayer has done to earn the profits in question and where he has done it – focus on what the taxpayer instead of what other person or entity has done – question of source is a practical matter of fact – must have regard to the whole of the circumstances – apportionment is not permissible – section 14 of the Inland Revenue Ordinance ('IRO')

Panel: Benjamin Yu SC (chairman), Lawrence Lai Wai Chung and Kenneth Leung Kai Cheong.

Dates of hearing: 7, 8, 13, 14, 15 and 19 November 2001.
Date of decision: 18 June 2002.

The taxpayer, a private company in Hong Kong, appealed from the determination of the Commissioner of Inland Revenue who confirmed the profits tax assessment for the four years of assessment 1995/96, 1996/97, 1997/98 and 1998/99.

The taxpayer contended that the profits in question were wholly derived outside Hong Kong and should not be subject to profits tax. Alternatively, it was said that the profits were derived partly from outside Hong Kong and the profits should be apportioned and only that part of the profits which was derived in Hong Kong should be taxed.

The facts appear sufficiently in the following judgment.

Held:

1. The Board found the two witnesses called by the taxpayer were witnesses of truth and that the Board could generally rely on their evidence as to primary facts. On the evidence before the Board, the following findings of fact were made:

   (a) the taxpayer's profits were derived from trading, that is, (i) the sale and purchase of raw materials and (ii) the sale and purchase of finished products;

   (b) more particularly, the profits were generated from the 'mark-up' in the prices, both with regard to raw materials and to the finished products;

(c) the taxpayer did not itself hire any staff in Hong Kong to carry out the trading activities; instead it engaged the services of Company H at a fee; these services were performed by Company H in Hong Kong;

(d) Company H acted at all material times as the agent of the taxpayer in issuing and receiving the orders for the sale and purchase, arranging for shipping and transportation and in effecting or receiving payment, Company H acted strictly on the instructions of Mr D;

(e) the taxpayer's margin of profits, or mark-up, was pre-determined by Mr D, who was the person in control of both the taxpayer and Company B; in other words, Mr D was in a position to determine how much or how little profits the taxpayer would make on each transaction;

(f) finally, if and in so far as it is necessary for the taxpayer's case to establish that Mr G and certain staff of the factory were also employed by the taxpayer, the Board was not satisfied that the taxpayer had discharged the burden of proof. Whilst Mr G may have a genuine belief that his salary was paid partly by Company B and partly by the taxpayer, the fact remained that the taxpayer had not, despite the opportunity available to it, produced the accounting records of the taxpayer to show that it did discharge any such liability. The Board had already recorded that the taxpayer's representative informed the Commissioner in a letter dated 9 September 1998 that all remuneration received by Mr G was borne by Company B. This was plainly inconsistent with the suggestion that the remuneration of Mr G and his subordinates was paid by the taxpayer.

2. By section 14 of the IRO, profits tax is chargeable, for each year of assessment, 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.

3. In determining whether the profits arose in or were derived from Hong Kong, the broad guiding principle is that one should look to see *what* the taxpayer has done to earn the profits in question and *where* he has done it (see HK-TVBI v Commissioner of Inland Revenue [1992] AC 397 at 407D per Lord Jauncey of Tullichettle at page 477 and F L Smith v Greenwood [1921] 3 KB 583 at 593 per Atkin LJ). It is important to focus on what the taxpayer – and not what other person or entity – has done, see Commissioner of Inland Revenue v Wardley Investment Services (Hong Kong) Ltd [1992] 3 HKTC 703 at 729 per Fuad JA.

4. The present case was one where the activities which brought in the profits were trading. In such a case, one factor one naturally looked at was where the taxpayer

obtained the buyer's order for the goods and where the taxpayer placed its order with the seller for the goods to meet the buyer's requirements: see per Godfrey J in Exxon Chemical International Supply SA v Commissioner of Inland Revenue (1989) 3 HKTC 57 at 100 and per Litton VP in Commissioner of Inland Revenue v Magna Industrial Company Ltd (1996) 4 HKTC 176.

5. This was the approach the Board should be bearing in mind when it considered the ultimate question of source as a practical matter of fact.

6. As to the issue of whether Company H's acts should be treated as the acts of the taxpayer, in the view of the Board, the acts of Company H should be regarded in law as the acts of the taxpayer. Whatever Company H did was done in the name of the taxpayer, and was intended to have binding effect on the taxpayer. The Board saw no material distinction between the present case and one where a taxpayer hires staff and sets up offices in Hong Kong to carry out the activities which Company H was tasked by this taxpayer to carry out.

7. In the present case, the profits in question, whether derived from the sale of raw materials or the sale of finished products, were the result of the taxpayer acting as the bridge between the sellers and buyers. In the view of the Board, that activity took place in Hong Kong.

8. On the evidence, there were a number of reasons why Hong Kong was chosen. Mr D no doubt also had his reasons for structuring the affairs of Company B and of the taxpayer in the way he did. But the reasons did not quite matter. What was important was what actually happened, in particular, what the operations which gave rise to the profits in questions were and where those operations took place.

9. The Board did not accept the taxpayer's contention that its profits were derived from activities in the Mainland. Whilst it was true that negotiations with Company E or with the raw material suppliers may have been conducted outside Hong Kong, one must not forget that those negotiations were conducted by Mr G and his staff. Whilst such negotiations would also ensure to the benefit of the taxpayer, the Board doubted whether it was possible to say that when they were carrying out those negotiations, they were also acting on behalf of the taxpayer, for they appeared to the Board on the evidence to be Company B's staff and it was in the interest of Company B to negotiate with Company E and the raw material suppliers in its role as manufacturer.

10. In any event, even if Mr G and his staff could be said to be acting for the taxpayer as well in those negotiations, this was only part of the picture. The Board must have regard to the whole of the circumstances. Here, the taxpayer earned its profit by reason of its being put in a position to earn a 'mark-up' from the buying and selling of

raw materials and finished products. Not only were the transactions brought together through the taxpayer operating in Hong Kong – and the Board noted that Company E was also a Hong Kong company with its offices in Hong Kong, Hong Kong was also the finance and shipping centre for the taxpayer's trading operations, both in respect of raw materials and the finished products. In all the circumstances, the Board concluded that the profits were derived from Hong Kong.

11. As to the question of whether the profits can and should be apportioned, in D64/91, IRBRD, vol 6, 484 and D8/00, IRBRD, vol 15, 268, the Board came to the conclusion that it was bound by Hong Kong authorities to the effect that apportionment was not permissible. Even if section 14 of the IRO was to be construed as allowing apportionment, the Board would not have thought that the facts of the present case would merit an apportionment.

Appeal dismissed.

Cases referred to:

HK-TVBI v Commissioner of Inland Revenue [1992] AC 397
F L Smith v Greenwood [1921] 3 KB 583
Commissioner of Inland Revenue v Wardley Investment Services (Hong Kong) Ltd [1992] 3 HKTC 703
Commissioner of Inland Revenue v Euro Tech (Far East) Limited (1995) 4 HKTC 30
Exxon Chemical International Supply SA v Commissioner of Inland Revenue (1989) 3 HKTC 57
Commissioner of Inland Revenue v Magna Industrial Company Ltd (1996) 4 HKTC 176
D64/91, IRBRD, vol 6, 484
D8/00, IRBRD, vol 15, 268

Lee Yun Hung for the Commissioner of Inland Revenue.
Ho Chi Ming Counsel instructed by Messrs Lawrence Cheung CPA Company Limited for the taxpayer.

Decision:

The appeal

1. Company A ('the Taxpayer') appeals from the determination of the Commissioner of Inland Revenue ('the Commissioner') dated 26 February 2001 ('the Determination'). In the Determination, the Commissioner

(a) confirmed the profits tax assessment for the year of assessment 1995/96 of $894,128 with tax payable thereon of $147,531;

(b) confirmed the profits tax assessment for the year of assessment 1996/97 of $6,368,663 with tax payable thereon of $1,050,829;

(c) confirmed the profits tax assessment for the year of assessment 1997/98 of $11,136,448 with tax payable thereon of $1,653,762; and

(d) confirmed the profits tax assessment for the year of assessment 1998/99 of $5,278,930 with tax payable thereon of $844,628.

2. The Taxpayer challenges the Determination contending that the profits in question were wholly derived outside Hong Kong and should not be subject to profits tax. Alternatively, it is said that the profits were derived partly from outside Hong Kong and the profits should be apportioned and only that part of the profits which was derived in Hong Kong should be taxed.

Background

3. The following background facts are not in dispute:

(a) The Taxpayer was incorporated as a private company in Hong Kong on 20 October 1994 and commenced business on 25 July 1995.

(b) Company B was incorporated in the People's Republic of China and is and was at the material time a wholly-owned subsidiary of the Taxpayer. Company B operated a factory in City C, China for the manufacture of footwear products.

(c) Mr D, now deceased, was the person who controlled both the Taxpayer and Company B.

(d) The nature of the Taxpayer's business was described as trading in raw materials and finished goods of footwear and investment holding.

(e) Company E was the only customer of the Taxpayer during the years of assessment 1995/96 and 1996/97. For the years of assessment 1997/98 and 1998/99, the Taxpayer also had other customers.

(f) The Taxpayer purchased raw materials from various suppliers, some local but mostly overseas, and earned a profit by on-selling them to Company B. The Taxpayer also derived profits when it purchased the finished products from Company B and on-sold the same to Company E; and later, other customers as well.

The witnesses

4. The Taxpayer called two witnesses. The first witness was a Miss F and the second witness was Mr G.

5. Miss F was at the relevant time a shipping manager of a company called Company H. We summarise Miss F's evidence below:

(a) Company H provided various management services to its customers for a fee.

(b) During the relevant years of assessment, the Taxpayer did not retain any staff of its own in Hong Kong but engaged Company H to handle all shipping and banking transactions on its behalf. Banking transactions included applications for letters of credit (in the Taxpayer's name) for the purchase of raw materials as well as the presentation of documents upon letters of credit opened by the buyers. Company H also handled all orders for the Taxpayer. These were the orders for purchase of raw materials from suppliers and orders for the sale of the same to Company B, as well as orders for purchase of the finished products from Company B and orders for the sale of the same to Company E and to other customers. In addition, Company H handled the transportation of finished goods from China to Hong Kong and delivery of the same to the forwarder to be stored in warehouse in Hong Kong.

(c) In the course of these transactions, Company H's staff would be issuing documents which bear the name of the Taxpayer instead of that of Company H. Company H's staff would follow the instructions of the Taxpayer with regard to all transactions, including prices, time of delivery etc.

(d) The Taxpayer's director, Mr D, went to Company H about three to four times a year mainly to deal with financing matters. If Company H needed instructions on matters such as whether a particular date of delivery or price adjustment was acceptable, it generally obtained those via fax from Company B.

6. Mr G was the factory manager of Company B in charge of the manufacturing operation. There is a question over whether Mr G was also employed as a staff of the Taxpayer.

We shall deal with the evidence on this at a later stage. We summarise below the relevant part of Mr G's evidence:

(a) Mr D was a Taiwanese and he set up the Taxpayer in Hong Kong because, according to Mr G, Taiwanese were not supposed to establish companies directly in China.

(b) At the beginning, Company E was the only customer. Mr G was responsible for discussing with Company E's representatives how to develop the products. He also negotiated with Company E on the cost of the production. Such discussions or negotiations were carried out either at the office of Company B or at Company E's office in City I, China. The Taxpayer produced a copy of a cost breakdown summary. This document was in Company E's printed form and shows the total factory costs of a product being broken down into material costs, direct labour costs, indirect labour costs, manufacturing overhead, sales or administration overhead, development overhead, profit margin, less a discount amount. We were also shown a cost confirmation memo, also in Company E's printed form, evidencing agreement between Company E and the factory on the cost for a particular model.

(c) The orders from Company E first came in the form of a list generated by Company E's headquarters in Country J. Mr G called the list 'pre-advised orders'. The list would cover a number of prospective orders. This list was sent via Company E's Hong Kong office to Company E's liaison office in China and was sent by fax to Company B. Company B was expected to check the list and confirm the shipping dates. Thereafter, Company E would issue what Mr G calls the official order. The official orders were addressed to the Taxpayer. We have seen a copy of the official order. It was issued in the name of '[Company E]', a company which was stated on the face of the invoice to be incorporated in Hong Kong and with a Hong Kong address. The order was addressed to the Taxpayer in Hong Kong and contained a request for immediate confirmation. Mr G said that the official order would first be received in City C. It would be sent by courier to Company H. He did not know whether Company H would confirm the order with Company E. After Company H received Company E's order, it would generate a corresponding order to Company B. Company E would in due course open a letter of credit in favour of the Taxpayer.

(d) The goods were manufactured in City C. When they were ready, Company H would arrange for transportation of the goods from City C to Hong Kong and deliver them to Company E's designated warehouse in Hong Kong.

(e) The price at which the Taxpayer invoiced Company E was the price which he had earlier negotiated and agreed with Company E. The price which Company B would charge the Taxpayer for the finished goods would be at a 7% discount. That percentage was determined by Mr D.

(f) Mr G explained why the official orders had to be issued to the Taxpayer instead of Company B: letters of credit could not be issued to the City C factory because of foreign exchange control. They had to be issued to the Taxpayer in Hong Kong instead. Mr G further explained why the purchase orders could not be issued by Company E's office in City I but were issued by its Hong Kong office. This was because Company E was not allowed to have business activity in China. It only had permission to operate a liaison office in China.

(g) Mr G was the person ultimately responsible for acquiring raw materials. Orders for the purchase of raw materials were placed by Company B with the Taxpayer. Company H would receive those orders on behalf of the Taxpayer and would place corresponding orders with raw material suppliers. These suppliers were either selected from the list of accredited suppliers approved by Company E or with suppliers sourced by Mr G himself.

(h) The raw materials would be delivered to the Taxpayer in Hong Kong and Company H would arrange for the transport of the materials to City C. Company H would not undertake any inspection of the raw materials. Mr G explained that Hong Kong was selected as the port of discharge because of its efficiency. This went on until 1998 when Company B purchased raw materials directly from suppliers.

(i) Mr G and his staff in City C handled negotiations with raw material suppliers.

(j) Mr G's salary was remitted to his wife in Taiwan. He believed that he received half of his salary from the Taxpayer and the other half from Company B. However, the Taxpayer's representative, Messrs Lawrence Cheung CPA Co Ltd, told the Commissioner in a letter dated 9 September 1998 that all remuneration received by Mr G was borne by Company B.

(k) The price at which the raw materials would be sold to Company B was determined by Mr D.

7. Apart from calling Miss F and Mr G, the Taxpayers also relied on an edited version of a statement by Mr K. He was a shipping clerk in Company H's employ. In paragraph 4 of this statement, Mr K stated that Company E would send orders to Company H two to three times every month, and there were some 60 to 70 orders on each occasion. When Mr G gave evidence,

he disputed this part of Mr K's witness statement. As stated above, Mr G's version was that Company E sent the orders to the Taxpayer via Company B.

The Taxpayer's arguments

8. Mr Ho, for the Taxpayer, submitted that the profits in question arose from the Taxpayer's business in the Mainland. He argued that Company H had no relationship with the Taxpayer and that it was an independent contractor. He contended that Company H's activities did not bring about the profits, that mere receipt of copies of purchase orders, preparing letters of credit, handling letters of credit issued by Company E and handling delivery did not earn the profits in question. He contended that the profits were earned by the negotiation and activities in the Mainland. He argued that when Mr G negotiated with Company E, he was doing so both for the Taxpayer and Company B. Mr Ho contended that the Taxpayer paid part or the whole of the remuneration of Mr G and of his subordinates working in the Mainland.

The Commissioner's arguments

9. Mr Lee, for the Commissioner, reminded us that we must not confuse the activities of Company B with those of the Taxpayer. He argued that Company H's business activities in Hong Kong should be treated as those of the Taxpayer in Hong Kong, and that the Taxpayer earned its profits by what it did in Hong Kong. He disputed that Mr G and his subordinates could be treated as the employees of the Taxpayer, and contended that their activities were solely the activities of Company B.

Findings

10. We find both Miss F and Mr G to be witnesses of truth and that we can generally rely on their evidence as to primary facts. On the evidence before us, we make the following findings of fact:

(a) the Taxpayer's profits were derived from trading, that is, (i) the sale and purchase of raw materials and (ii) the sale and purchase of finished products;

(b) more particularly, the profits were generated from the 'mark-up' in the prices, both with regard to raw materials and to the finished products;

(c) the Taxpayer did not itself hire any staff in Hog Kong to carry out the trading activities; instead it engaged the services of Company H at a fee; these services were performed by Company H in Hong Kong;

(d) Company H acted at all material times as the agent of the Taxpayer in issuing and receiving the orders for the sale and purchase, arranging for shipping and

transportation and in effecting or receiving payment, Company H acted strictly on the instructions of Mr D;

(e) the Taxpayer's margin of profits, or mark-up, was pre-determined by Mr D, who was the person in control both of the Taxpayer and of Company B; in other words, Mr D was in a position to determine how much or how little profits the Taxpayer would make on each transaction;

(f) finally, if and in so far as it is necessary for the Taxpayer's case to establish that Mr G and certain staff of the factory were also employed by the Taxpayer, we are not satisfied that the Taxpayer has discharged the burden of proof. Whilst Mr G may have a genuine belief that his salary was paid partly by Company B and partly by the Taxpayer, the fact remains that the Taxpayer has not, despite the opportunity available to it, produced the accounting records of the Taxpayer to show that it did discharge any such liability. We have already recorded that the Taxpayer's representative informed the Commissioner in a letter dated 9 September 1998 that all remuneration received by Mr G was borne by Company B. This is plainly inconsistent with the suggestion that the remuneration of Mr G and his subordinates was paid by the Taxpayer.

The law

11. By section 14 of the IRO, profits tax is chargeable, for each year of assessment, 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.

12. In determining whether the profits arose in or were derived from Hong Kong, the broad guiding principle is that one should look to see *what* the taxpayer has done to earn the profits in question and *where* he has done it (see HK-TVBI v Commissioner of Inland Revenue [1992] AC 397 at 407D per Lord Jauncey of Tullichettle at page 477 and F L Smith v Greenwood [1921] 3 KB 583 at 593 per Atkin LJ). It is important to focus on what the *taxpayer* – and not what other person or entity – has done, see Commissioner of Inland Revenue v Wardley Investment Services (Hong Kong) Ltd [1992] 3 HKTC 703 at 729 per Fuad JA.

13. In the HK-TVBI case, Lord Jauncey observed at page 480 that:

> ' *In the view of their Lordships it can only be in rare cases that a taxpayer with a principal place of business in Hong Kong can earn profits which are not chargeable to profits tax ...'*

14. Barnett J observed in Commissioner of Inland Revenue v Euro Tech (Far East) Limited (1995) 4 HKTC 30 at page 56:

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

15. The present case is one where the activities which brought in the profits were trading. In such a case, one factor one naturally looks at is where the taxpayer obtained the buyer's order for the goods and where the taxpayer placed its order with the seller for the goods to meet the buyer's requirements: see per Godfrey J in Exxon Chemical International Supply SA v Commissioner of Inland Revenue (1989) 3 HKTC 57 at 100. In Commissioner of Inland Revenue v Magna Industrial Company Ltd (1996) 4 HKTC 176, Litton VP said, also in the context of a case where the profits resulted from trading activities:

> ' *Obviously the question where the goods were bought and sold is important. But there are other questions. For example: How were the goods procured and stored? How were the sales solicited? How were the orders processed? How were the goods shipped? How was the financing arranged? How was payment effected?'*

This is the approach we shall be bearing in mind when we consider the ultimate question of source as a practical matter of fact. Before doing so, we should review the decision of the Court in Exxon and the other authorities on the question of source in the context of companies which derived their profits from trading.

16. In Exxon, the taxpayer was the wholly-owned subsidiary of a multi-national corporation in the USA. It carried on business in Hong Kong and the Bahamas. In the course of business in Hong Kong, it purchased goods from one affiliate within the group and sold them to another at a profit. At page 100, Godfrey J said:

> ' *ECIS submits that before deciding where a profit is derived (or, I suppose, where it arises) it is necessary first to determine* ***how*** *the profit is derived and then (and then only) secondly to determine* ***where*** *it is derived. I am content for the purposes of the present case to accept this; having already demonstrated* ***how*** *the profit on the transaction in question was derived I can satisfy myself that it was derived from a "mark-up" on sales (as ECIS itself submitted) and I can go on to consider* ***where*** *it was derived. I ask myself: Where did ECIS obtain the buyer's order for the goods? The answer is that it obtained that order in Hong Kong. I ask myself: Where did ECIS place its order with the*

> *seller for the goods to meet the buyer's requirement? The answer is that it placed that order from Hong Kong. These acts, the obtaining of the buyer's order in Hong Kong and the placing of the order with the seller from Hong Kong, are the foundations of the transaction; for it is the differential between the selling price and the buying price ("the mark-up") which generates, indeed represents, the profit.'*

At page 102, the judge continued:

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

17. Exxon Chemical International Supply SA v Commissioner of Inland Revenue was applied in Commissioner of Inland Revenue v Euro Tech (Far East) Limited (1995) 4 HKTC 30. There, the taxpayer company was a subsidiary of a UK company. Its business was the marketing and trading of electronic and medical equipment. The equipment was bought from other companies in UK within the group. It entered into distributorship agreement with one company in Korea and another company in Singapore. Having received orders from these companies, the taxpayer sent an order for the equipment required to the relevant company in UK. The equipment was then shipped direct to the Korean or Singaporean buyers. The difference between the price at which the taxpayer bought the goods from UK and at which it sold to Korea or Singapore represented the profit in issue. The Board of Review found that the taxpayer was no more than a mere puppet of its masters in the UK, that it did nothing except processing pieces of paper and collecting the money. The Board found no evidence that any negotiations took place in Hong Kong or that Hong Kong played any role other than as a post box. The Board's decision that the profits in question were not chargeable to tax was reversed by Barnett J. He held that Exxon was indistinguishable and stated:

> *' Like Exxon and so many other trading companies, the taxpayer was doing no more than bringing together the complementary needs of sellers and buyers, and that bringing together it did in Hong Kong ...'*

18. The facts in CIR v Magna Industrial Co Ltd were rather exceptional. As alluded above, the profits of the taxpayer were generated by trading activities. The goods were purchased by the taxpayer from its wholly-owned subsidiary in Hong Kong. The goods were sold via a network of independent contractors, known as 'export managers' outside Hong Kong. The duties of the export managers were to find suitable distributors, train and supervise them and promote the sale of the products. Litton VP observed (at page 262) that the exceptional feature in the case was that the sales of essentially low-value products, in large numbers, were effected overseas by a network of independent contractors, resident in their own regions, who nevertheless had the authority to bind the taxpayer to specific orders. He commented that such features were 'rare' and underpinned the Board's conclusion that the profits were derived from a source outside Hong Kong.

Company H should be treated as the Taxpayer's agent

19. Before turning to the question of source, we shall first address the issue of whether Company H's acts should be treated as the acts of the Taxpayer. In our view, the acts of Company H should be regarded in law as the acts of the Taxpayer. Whatever Company H did was done in the name of the Taxpayer, and was intended to have binding effect on the Taxpayer. We see no material distinction between the present case and one where a taxpayer hires staff and sets up offices in Hong Kong to carry out the activities which Company H was tasked by this Taxpayer to carry out.

Source of the profits

20. In the present case, the profits in question, whether derived from the sale of raw materials or the sale of finished products, were the result of the Taxpayer acting as the bridge between the sellers and buyers. In our view, that activity took place in Hong Kong. On the evidence, there were a number of reasons why Hong Kong was chosen. Mr D no doubt also had his reasons for structuring the affairs of Company B and of the Taxpayer in the way he did. But the reasons do not quite matter. What is important is what actually happened, in particular, what the operations which gave rise to the profits in questions were and where those operations took place. We do not accept the Taxpayer's contention that its profits were derived from activities in the Mainland. Whilst it is true that negotiations with Company E or with the raw material suppliers may have been conducted outside Hong Kong, one must not forget that those negotiations were conducted by Mr G and his staff. Whilst such negotiations would also enure to the benefit of the Taxpayer, we doubt whether it is possible to say that when they were carrying out those negotiations, they were also acting on behalf of the Taxpayer, for they appear to us on the evidence to be Company B's staff and it was in the interest of Company B to negotiate with Company E and the raw material suppliers in its role as manufacturer. In any event, even if Mr G and his staff can be said to be acting for the Taxpayer as well in those negotiations, this is only part of the picture. We must have regard to the whole of the circumstances. Here, the Taxpayer earned its profit by reason of its being put in a position to earn a 'mark-up' from the buying and selling of raw materials and

finished products. Not only were the transactions brought together through the Taxpayer operating in Hong Kong – and we note that Company E is also a Hong Kong company with its offices in Hong Kong, Hong Kong was also the finance and shipping centre for the Taxpayer's trading operations, both in respect of raw materials and the finished products. In all the circumstances, we have come to the conclusion that the profits were derived from Hong Kong.

Apportionment of profits

21. Lastly, we turn to the question whether the profits can and should be apportioned. In D64/91, IRBRD, vol 6, 484 and D8/00, IRBRD, vol 15, 268, the Board came to the conclusion that it was bound by Hong Kong authorities to the effect that apportionment is not permissible. Even if section 14 of the IRO is to be construed as allowing apportionment, we would not have thought that the facts of the present case would merit an apportionment.

Disposal of the appeal

22. In the circumstances, the appeal is dismissed and the assessments are confirmed.