Case No. D24/12

Profits tax – interposing group company taking other's profits after reorganization – whether interposing company liable to profits tax – whether any 'business' carried on – whether source of profits coming from 'business' – sections 14 and 68(9) of the Inland Revenue Ordinance (Chapter 112) ('the IRO').

Panel: Colin Cohen (chairman), Chyvette Ip and Kong Chi How Johnson.

Dates of hearing: 10 February 2012, 7 March 2012, 2 to 4 May 2012.
Date of decision: 14 August 2012.

Companies A1 ('A1') and A2 ('A2') were companies incorporated in Hong Kong in the 1980's. Companies A3 ('A3') and A4 ('A4') were companies incorporated in Country B in 1995. A1, A2, A3 and A4 (together referred to as 'Taxpayers') were members of a group of companies ('Group'). Until 1996, A1 carried on the business of design and manufacture of computer related components in Hong Kong while A2 was a dormant company. At all material times, A3 and A4 were neither registered in Hong Kong/PRC nor did they apply any business registration in Hong Kong/PRC.

In 1996, the Group went through a reorganization. The business of manufacture and sales of computer related components was allegedly split and allocated as follows: (a) A1 was responsible for provision of management support services; (b) A2 was responsible for provision of procurement support services; (c) A3 was responsible for manufacturing; (d) A4 was responsible for sales and marketing. Allegedly, the reorganization was done for fear of customers generated by the impending return of the sovereignty of Hong Kong to the PRC that were crystallized by the event on 4 June 1989.

In 2000, the Group went through another reorganization, in that A1, A2, A3 and A4 became wholly owned subsidiaries of Company A5 ('A5'), a company incorporated in Country C and listed in Country D.

In 2009, the 100% equity interest in A1, A2, A3 and A4 were disposed of by the Group.

The Assistant Commissioner raised Assessments on A3 and A4 for the years 1999/2000 to 2006/07 ('Assessments') pursuant to sections 14, 61 and 61A of the IRO. Alternatively, the Assistant Commissioner was of the view that A3 and A4 were respectively vehicles used to book the profits earned by A2 and A1 and that the profits as booked should be attributable to A2 and A1. For the above reasons, the Assistant Commissioner also raised on A1 and A2 the Additional Profits Tax Assessments

for the years 1999/2000 to 2006/07 ('Additional Assessments') pursuant to sections 61 and 61A of the IRO. The Taxpayers objected to the Assessments and Additional Assessments. The objections were dismissed by the Commissioner, but were revised by charging assessable profits as per the accounts of A3 and A4. The Taxpayers appealed against the Assessments and Additional Assessments.

In these proceedings, the primary concern was whether A4 should be liable for profits tax under the Assessments for 1999/2000 to 2006/07. A4's appeal was heard at the same time in respect of the appeals by A1, A2 and A3. The Taxpayers called Mr K, allegedly the Ex Vice-President of Operations of A5, to give evidence.

Held:

Liability for profits tax

1. For a taxpayer to be liable to pay profits tax under section 14(1) of the IRO, the following conditions had to be satisfied: (a) the taxpayer must carry on a trade, profession or business in Hong Kong; (b) the profits to be charged must be 'from such trade, profession or business'; (c) the profits must be 'profits arising or derived from' Hong Kong. (CIR v Hang Seng Bank Ltd [1991] 1 AC 306 considered)

Whether A4 carried out business

2. The word 'business' referred to 'the exercise of an activity in an organized and coherent way and one which is directed in an end result' or '[prima facie] any gainful use to which it puts any of its assets prima'. A very small amount of intermittent activities could constitute the carrying on of a business. (Lee Yee Shing v CIR (2008) 11 HKCFAR 6, Calkin v CIR [1984] 1 NZLR 440, Rangatira Ltd v CIR [1997] STC 47, American Leaf Blending Co Sdn BhD v Director-General of Inland Revenue [1979] AC 676, CIR v Bartica Investment Ltd (1996) 4 HKTC129 considered)

3. A4 did carry on a business at all material time. The business of A4 was sales and marketing of products to the customers, and was carried out in Hong Kong.

Source of profits of A4

4. One had to consider the individual acts of a taxpayer (which could include the activities of its agents) to ascertain what was the profit-producing act and to see where that act was done. The act referred to act which produced the gross profit of each individual transaction entered into by the taxpayer which (when added up at the end of the accounting period) formed its net profit of

the period. (Kwong Mile Services Ltd v CIR (2004) 7 HKCFAR 275, ING Baring Securities (Hong Kong) Ltd v CIR (2007) 10 HKCFAR 417 considered)

5. In this regard, there was no 'but for' test and one must look carefully to distinguish acts which although commercially essential for the making of the profit were only antecedent or incidental in the making of the profit (for example negotiations and customer relationship work), and acts which were simply profit-producing. In the circumstances, the Board found that the profits of A4 arose in and derived from Hong Kong. (CIR v Datatronic Ltd [2009] 4 HKLRD 675 considered)

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

Chiang Sham Lam of Messrs Anthony S L Chiang & Co for the Taxpayer.
Stewart Wong Senior Counsel, Bonnie Cheng Counsel instructed by Francis Kwan Senior Government Counsel of the Department of Justice for the Commissioner of Inland Revenue.

Decision:

Introduction

1. We refer to our decisions handed down in D21/12, D22/12 and D23/12.

2. We refer to our reasons given in each of those decisions for dismissing those appeals.

Conclusion

3. Hence, adopting those reasoning and the facts that we have found, we come to the conclusion that this appeal must also be dismissed.

4. We refer to section 68(9) of the IRO whereby there is power to this Board to make an order for costs. We order that a sum of HK$5,000 be awarded as costs and the sum be added to the tax charged and recovered accordingly.