Case No. D33/91

Profits tax – whether company carrying on business or dormant – whether carrying on business in Hong Kong.

Panel: William Turnbull (chairman), Colin Cohen and Henry Tang Ying Yen.

Date of hearing: 28 February 1991.
Date of decision: 10 July 1991.

The taxpayer was a company incorporated in Hong Kong. The taxpayer earned interest income from deposits which it maintained with a bank in Hong Kong and it was agreed that the interest income was earned in Hong Kong. It was submitted that the taxpayer was a dormant company which was not carrying on any business or alternatively, if it were carrying on business it was carrying on business outside of Hong Kong because that is where it was claimed its controlling shareholder and director was resident and from where he operated the taxpayer.

Held:

The taxpayer was carrying on business because it had a number of activities of a business nature. Whatever was done by the taxpayer was done in Hong Kong and accordingly the taxpayer was carrying on business in Hong Kong and the interest income had been correctly assessed to tax.

Appeal dismissed.

[Editor's note: The taxpayer has filed an appeal against this decision.]

Cases referred to:

Commissioner of Inland Revenue v Hang Seng Bank Limited (PC) [1990] STC 733
CIR v Maxse 12 TC 41
J P Harrison (Watford) Limited v Griffiths 40 TC 281
Louis KWONG Kwan Nang and Carlos KWONG Kwok Nang v CIR 2 HKTC 541
American Leaf Blending Co Sdn Bhd v Director General of Inland Revenue [1979] AC 676
D15/87, IRBRD, vol 2, 373
Sulley v Attorney General [1860] 2 TC 149
Grainger and Son v Gough [1896] 3 TC 462

F L Smidth & Co v F Greenwood [1922] 8 TC 193
The Egyptian Hotels Ltd v Mitchell 6 TC 542
Malayan Shipping Co Ltd v Federal Commissioner of Taxation 8 ATD 75
D18/88, IRBRD, vol 3, 241
D7/89, IRBRD, vol 4, 185
D65/88, IRBRD, vol 4, 71
LAM Woo Shang v CIR 1 HKTC 123
IRC v The Korean Syndicate Limited 3 TC 181
CIR v The South Behar Railway Co Ltd 12 TC 657
D26/88, IRBRD, vol 3, 299
San Paulo (Brazilian) Railway Co Ltd v Carter 3 TC 407

Lee Kang Bor for the Commissioner of Inland Revenue.
David Smith of KPMG Peat Marwick for the taxpayer.

Decision:

This is an appeal by a private limited company incorporated in Hong Kong against a number of profits tax assessments for the years of assessment 1984/85 to 1987/88. The appeal falls into two separate parts. The first part relates to the years of assessment 1984/85 and 1985/86. These assessments were raised on the company and no objection was made against them. Subsequently application has been made under section 70A of the Inland Revenue Ordinance to have the assessments corrected. The second part of the appeal relates to the years of assessment 1986/87 and 1987/88 where the Taxpayer has duly filed notice of appeal against the two assessments. It is convenient for us to first deal with the facts.

The facts of the case are as follows:

1. The Taxpayer was a company incorporated in Hong Kong and its business was described as that of 'investments and general merchants'.

2. The original tax representative of the Taxpayer was a firm of certified public accountants which was also the auditor of the Taxpayer ('the original tax representative'). The only income of the Taxpayer throughout the period in question was interest earned by the Taxpayer on US dollar deposits which it maintained with a bank in Hong Kong. For the years of assessment 1984/85 and 1985/86 the Taxpayer filed two tax returns through the original tax representative with the Inland Revenue Department in which the assessable profits being interest earned were offered for taxation and the nature of the business carried on was stated to be 'investments and general merchants'. The tax returns were signed by a director of the Taxpayer, Mr X, and were supported by audited accounts signed by Mr X, and another director. For the years of assessment 1986/87 and 1987/88 the Taxpayer filed two tax returns

through the original tax representative with the Inland Revenue Department in which the profits being interest earned were not offered for taxation and the assessable profits were stated to be nil. The nature of the business carried on was stated to be 'investments and general merchants'. The tax returns were signed by the director, Mr X, and were supported by accounts signed by Mr X and another director and audited by the original tax representative.

3. In August 1987 or some date prior thereto the Taxpayer instructed new tax representative ('the tax representative') to advise it and through the tax representative applied by letter dated 17 April 1987 to the Commissioner of Inland Revenue to have the profits tax assessments for the years of assessment 1984/85 and 1985/86 revised pursuant to section 70A of the Inland Revenue Ordinance on the following grounds:

> ' The grounds of our application are that the company does not carry on a trade or business in Hong Kong during the years of assessment under review and therefore no profits tax liability arises. Please be advised that the company has to date remained dormant and as such no liability can arise under section 14 or 15(1)(f) of IRO in this instance. For your information we advise that the board meetings of the company all took place in New York and all the directors are US residents. The company has conducted no other business apart from the placement of cash in US dollar time deposits.'

The original tax representative filed nil returns for the years of assessment 1986/87 and 1987/88 on 23 September 1987 and 20 June 1988 respectively. It appears that the Taxpayer was simultaneously using the services of two different firms of advisers to represent it in its tax affairs. Notice was given by letter dated 15 April 1988 to the Commissioner of Inland Revenue that the Taxpayer had appointed the new tax representative to be its tax representative.

4. The two nil tax returns were not accepted by the assessor who assessed the Taxpayer to tax for the two years of assessment 1986/87 and 1987/88 on all of the interest earned by the Taxpayer in each of these two years.

5. The tax representative filed objections against both of the two assessments for the years of assessment 1986/87 and 1987/88. At the hearing of the appeal before the Board the tax representative appeared on behalf of the Taxpayer and no one from the original tax representative either appeared or gave evidence. For convenience and as stated above we refer in this decision to the new tax representative as simply 'the tax representative' and to the original tax representative as 'the original tax representative'.

6. The tax representative informed the Commissioner by letter dated 20 October 1988 that at the time of its incorporation in Hong Kong the intended business of the Taxpayer was to invest in properties as stated in the first object clause of the

memorandum of association of the Taxpayer. The tax representative further stated that due to the depressed state of the property market in 1984 the intended business never materialised. We find as a fact that the information provided to the Commissioner as set out in this paragraph is true and correct.

7. The Taxpayer had two shareholders one of whom was a Chinese person resident in Hong Kong, Mr Y, and one of whom was Mr X, an American resident in USA. Initially they each owned 50% of the issued shares of the Taxpayer. Subsequently with effect from 24 March 1986 Mr Y owned 51% of the issued share capital of the Taxpayer and Mr X reduced his shareholding to 49% thereof.

8. With effect from 1 May 1984 there were two directors of the Taxpayer one being Mr X and the other being another American resident outside of Hong Kong and believed to be the son-in-law of Mr X. They continued to be directors of the Taxpayer and were its only directors throughout the period in question. Mr X died in mid-1989. The other director ceased to be a director in late 1988. In late 1988 two persons resident in Hong Kong were appointed to be directors, one of whom was Mr Z. No minute books were produced and no company secretary was called to give evidence. Copies of some minutes of a formal nature were produced which stated that the meetings had been held in New York. The company secretary was an individual who used the same address as that of the original tax representative.

9. On or with effect from 7 May 1984 Mr X transferred to the Taxpayer a sum of US$2,365,433.2 from a fixed deposit maintained in the name of Mr X with the branch of a foreign bank in Hong Kong (which branch we refer to in this decision as ‘the bank’). The moneys were placed by the Taxpayer on fixed deposit for three months with the bank. When this account was opened with the bank there were five authorised signatories one of whom was Mr X. All instructions to the bank were given either by Mr X or Mr Z.

10. The original instructions given to the bank were that the original deposit was to be rolled over for periods of three months. These instructions were given to the bank by Mr X in his capacity as a director of the Taxpayer when he arranged for the initial deposit to be transferred from his own account to that of the Taxpayer.

11. At some time in November 1985 or earlier the original instructions to roll over the original deposit at three monthly intervals were cancelled and thereafter moneys were placed on deposit for periods of approximately one month with some additions being made thereto and a number of payments being made therefrom.

12. On 1 February 1985 a small sum of US$9,719.58 was received by the Taxpayer and placed on deposit and combined with the major deposit when it fell due and was rolled over. The nature and source of this additional deposit is not known.

13. When the deposit was rolled over on 7 November 1985 a payment of US$166,666.67 was made to a Chinese gentleman in Hong Kong. The nature of this payment is not known and it was followed by a series of monthly payments for similar amounts with the final seventh payment being made in May 1986. No evidence or explanation with regard to the nature of these payments made to a third party was given or can be found in any of the papers before the Board.

14. On 8 January 1986 an additional deposit of US$166,666.67 was made and on 5 February an additional deposit of US$12,812.37 was made. The nature and source of these additional deposits is unknown. According to the papers before the Board the sum of US$12,812.37 was the proceeds of the sale of Deutsch Marks belonging to the Taxpayer.

15. On 26 November 1986 an additional sum of US$140,000 was placed on deposit with the bank. The source of these funds was a transfer from A Limited which was an active company owned and/or operated by Mr X in Hong Kong.

16. Two additional deposits of $46,247.56 and $54,540.47 were made by the Taxpayer on 13 and 17 March 1987 respectively. The nature and source of these additional deposits is unknown.

17. By three payments made on 20 March 1987 and 23 April 1987 the Taxpayer transferred the entire balance of moneys including all accrued interest then on deposit with the bank in Hong Kong to or to the order of Mr X with the result that the director's current account of Mr X with the Taxpayer was substantially overdrawn.

18. Apart from the receipt of the funds which we have referred to above the moneys received by the Taxpayer was the interest which it received on the fixed deposits which it maintained with the bank in Hong Kong. When the moneys were paid to Mr X, the Taxpayer ceased to have any funds available to it and thereafter ceased to have any income. We have not set out above withdrawals made for the purpose of payment of tax in Hong Kong. These tax payments were either paid direct to the Hong Kong Government or through A Limited to which we refer in the next fact.

19. Mr X owned and/or operated A Limited, a company incorporated in Hong Kong. Little information is known by the Board about A Limited other than it was a trading company with an active office in Hong Kong with a Hong Kong resident, Mr Z, as its manager and director. Mr Z was called by the Taxpayer to give evidence and Mr Z said that he became a director of the Taxpayer in late

1988 to facilitate the liquidation of the Taxpayer. He had known Mr X for over fourteen years during which time he had reported to Mr X as part of his employment with A Limited.

20. The ultimate management and control of the Taxpayer was exercised by Mr X alone. Instructions were given to the bank by Mr X personally when he was in Hong Kong or were given through his agent, Mr Z, who was physically in Hong Kong, and on some occasions Mr Z gave instructions in Hong Kong using his own authority. With regard to verbal instructions being given by Mr X direct to the bank from New York we have no acceptable evidence. Written instructions in the form of letters when signed by Mr X all bore the Hong Kong address of the Taxpayer. The Taxpayer and Mr X when writing to the bank in relation to the affairs of the Taxpayer never used any address other than the Hong Kong address of the Taxpayer. So far as we are aware the Taxpayer had no other address.

21. No evidence was called with regard to the apparent change in the accounting policy of the Taxpayer in relation to the two years of assessment, 1984/85 and 1985/86 on the one hand and the years 1986/87 and 1987/88 on the other. The auditor who was the original tax representative was apparently of the opinion, that in respect of the first two years of assessment the Taxpayer was carrying on business in Hong Kong and that the interest earned by it in Hong Kong was subject to assessment to profits tax. For reasons unknown the same auditor formed the opinion that the interest earned by the Taxpayer in respect of the second two years was not subject to be assessed to profits tax in Hong Kong. No evidence was given by anyone representing the original auditor with regard to the change of opinion nor was any evidence given by the other director of the Taxpayer who signed all four sets of accounts.

22. The application made by the tax representative to amend the years of assessment 1984/85 and 1985/86 was rejected by the assessor.

23. The tax representative filed notice of objection to the refusal by the assessor to amend the two assessments and also against the two assessments to profits tax for the years of assessment 1986/87 and 1987/88.

24. By his determination dated 13 November 1990 the Commissioner confirmed the decision of the assessor not to amend the first two assessments and confirmed the profits tax assessments for the last two years.

25. The Taxpayer has appealed to this Board of Review against the determination of the Commissioner.

At the hearing of the appeal the representative for the Taxpayer submitted that the Taxpayer was not carrying on a trade, profession or business in Hong Kong and accordingly was not liable to be assessed to profits tax on the interest which it earned.

Alternatively he submitted that if a trade, profession or business was carried on, it was not carried on in Hong Kong. He submitted that both questions were questions of fact. He said that it was accepted that the profits which derived solely from interest on bank deposits had a source in Hong Kong.

The representative for the Taxpayer referred us to the following cases:

Commissioner of Inland Revenue v Hang Seng Bank Limited (PC) [1990] STC 733

CIR v Maxse 12 TC 41

J P Harrison (Watford) Limited v Griffiths 40 TC 281

Louis KWONG Kwan Nang and Carlos KWONG Kwok Nang v CIR 2 HKTC 541

American Leaf Blending Co Sdn Bhd v Director General of Inland Revenue [1979] AC 676

D15/87, IRBRD, vol 2, 373

Sulley v Attorney General [1860] 2 TC 149

Grainger and Son v Gough [1896] 3 TC 462

F L Smidth & Co v F Greenwood [1922] 8 TC 193

The Egyptian Hotels Ltd v Mitchell 6 TC 542

Malayan Shipping Co Ltd v Federal Commissioner of Taxation 8 ATD 75

With regard to the section 70A application the representative said that he accepted that it was necessary to show that an error or omission had been made in the original profits tax returns. He submitted that whether or not the Taxpayer carried on a business in Hong Kong during the relevant periods is a question of fact and that if the Board finds as a fact no such business was carried on then it follows as a fact that the profits tax returns which were prepared on the basis that the Taxpayer was carrying on a business in Hong Kong were erroneous. He referred the Board to Board of Review decisions D18/88, D7/89 and D65/88 and said that the facts before the Board proved that an error had been made.

The representative for the Commissioner submitted that this was not a case which came within the scope of section 70A of the Inland Revenue Ordinance. He said that section 70A cannot be used to extend the time limited by section 64 of the Inland Revenue Ordinance to allow a taxpayer to object to an assessment which has already become final

and conclusive under section 70. He referred us to Board of Review decision D18/88, IRBRD, vol 3, 241.

The representative for the Commissioner said that it was common ground that the interest income was taxable throughout the period in question if the Taxpayer had been carrying on a trade, profession or business in Hong Kong and he submitted that the Taxpayer had carried on business in Hong Kong during the four years in question. He referred to:

Louis KWONG Kwan Nang and Carlos KWONG Kwok Nang v CIR 2 HKTC 541

LAM Woo Shang v CIR 1 HKTC 123

IRC v The Korean Syndicate Limited 3 TC 181

CIR v The South Behar Railway Co Ltd 12 TC 657

D15/87, IRBRD, vol 2, 373

D26/88, IRBRD, vol 3, 299

The Egyptian Hotels Ltd v Mitchell 6 TC 542

San Paulo (Brazilian) Railway Co Ltd v Carter 3 TC 407

We will first deal with the question of whether or not the Taxpayer was carrying on business and if so where the business was carried on. We will do so in respect of all four years in question because as a matter of fact there is no reason to draw any distinction between any of the four years in question. Why the original tax representative drew a distinction between the first two years and the last two years and likewise why the two directors of the Taxpayer drew such a distinction we do not know. No evidence was called and no explanation was offered. It was quite clear that both the representative for the Taxpayer and the representative for the Commissioner in the submissions which they made to us drew no distinction whatsoever between any of the four years in question in this regard.

We find as a matter of fact that the Taxpayer was carrying on business and that the business which it carried on was carried on in Hong Kong. The first part of the case for the Taxpayer is that it was a dormant company which was not carrying on business at all. In all tax appeals the onus of proof is upon the taxpayer to prove that the determination is wrong and this the Taxpayer has failed to do. The Taxpayer was not a dormant company. The Taxpayer was receiving money and paying out money. It was borrowing money from one of its directors who had an active current account with the Taxpayer. On the facts before us the Taxpayer did more than simply place money on deposit with a bank. It was an active company. It is significant that the two directors of the Taxpayer and the original tax

representative were all of the opinion that the Taxpayer was carrying on business when they prepared and approved the audited accounts and the tax returns for the first two years in question. It is also significant that the tax returns which were signed by Mr X and filed by the original tax representative stated that the business of the Taxpayer was 'investments and general merchants'. No one has come forward to explain this or to say that a mistake was made. As we have stated the onus of proof is on the Taxpayer and the Taxpayer has failed to discharge the onus put upon it.

Having decided as a matter of fact that the Taxpayer was carrying on business it is a simple matter to decide where it was carrying on business. The case for the Taxpayer was that any business of the Taxpayer was carried on in New York where the board of directors met and where Mr X made decisions and gave instructions. With due respect we cannot accept this submission. To state the obvious a business is carried on where it is carried on, that is where the activities and/or assets comprising that business take place or are situated. In this case the activities clearly took place in Hong Kong and nowhere else. The Taxpayer received all of its moneys in Hong Kong and paid out all of its moneys in Hong Kong. The Taxpayer opened a bank account in Hong Kong and it operated that bank account in Hong Kong. It gave instructions for the operation of that bank account in Hong Kong and as stated in the facts we have no evidence to show that instructions were ever given to the bank by a person outside of Hong Kong. Mr X when he was outside of Hong Kong he did not give instructions direct to the bank but he instructed an agent in Hong Kong, Mr *Z*, and it was that agent who gave instructions to the bank. When Mr X gave written instructions he did so on paper bearing a Hong Kong address. Mr X went out of his way to show that all of the transactions of the Taxpayer were carried out in Hong Kong. Once again we point out that the onus of proof is upon the Taxpayer and again we note that it was the opinion of the original tax advisers and the two directors that the Taxpayer was carrying on business in Hong Kong. No evidence was called to explain or disprove this.

For the reasons given we find that the Taxpayer was carrying on business in Hong Kong. As it is conceded that the profits arose in Hong Kong that is the end of the matter and the appeal is dismissed in its entirety.

Having decided that the Taxpayer was carrying on business in Hong Kong in all four years in question it is not necessary for us to consider whether section 70A of the Inland Revenue Ordinance can apply to circumstances such as the present.