INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D37/95

Profits tax – profit arising in or derived from Hong Kong.

Panel: William Turnbull (chairman), Christopher Chan Cheuk and David Wu Chung Shing.

Date of hearing: 20 March 1995.
Date of decision: 20 July 1995.

Prior to the hearing of the appeal the Commissioner and the taxpayer reached a compromise. When the terms of the compromise were laid before the Board for approval it appeared that the compromise reached by the Commissioner was at variance with a high court decision in CIR v Euro Tech (Far East) Ltd. With some hesitation the Board approved the proposed compromise settlement on the basis that Crown Counsel for the Commissioner had said that the facts could be distinguished from previous cases.

A compromised case.

Case referred to:

Exxon Chemical International Supply SA v CIR 3 HKTC 57

So Chau Chuen for the Commissioner of Inland Revenue.
Dow Famulak of Messrs Baker & Mckenzie for the taxpayer.

Decision:

This is an appeal by a taxpayer against a number of assessments to profits tax which were raised in respect of the years of assessment 1985/86 to 1988/89. The appeal related to a number of matters of some complexity and at the request of the parties the case was set for hearing on 5 full consecutive days. The dates were fixed in consultation with the parties. Shortly before the case was due to be heard the representative for the Taxpayer wrote to the Board of Review informing the Board that there was a likelihood that the case would be resolved between the Taxpayer and the Commissioner. The representative enquired of the Board whether the Board would grant an adjournment of the case in the event that the parties were unable to reach a settlement. The Clerk to the Board replied to the parties that in the event of the appeal not being settled the Board would not grant an adjournment and would expect the parties to proceed with the substantive hearing of the appeal.

The Board would like to take this opportunity of placing on record that when a date has been fixed for the hearing of an appeal and due notice has been given to the parties it would only be in the most exceptional circumstances that the Board would consider an adjournment. The workload of the Board of Review is substantial and there has recently been a major increase in the number of appeals filed. If the Board is to operate efficiently it can only do so if the time table set for hearing cases is strictly followed.

In the event, the parties were able to reach a settlement and at the time and date fixed for the commencement of the hearing the representative for the Taxpayer and Crown Counsel representing the Commissioner tabled before the Board for approval the terms of settlement which the parties had reached. The representative for the Taxpayer addressed the Board and explained the circumstances of the case and outlined the facts. The compromise agreement signed by the parties was subject to the approval of the Board and was prima facie acceptable to the Board with the exception of one matter. This related to certain trading income of the Taxpayer which the Commissioner had originally decided was assessable to Hong Kong profits tax on the ground that it arose in or was derived from Hong Kong. The Taxpayer had argued that the income neither arose in nor derived from Hong Kong and was offshore income of the Taxpayer. The following is a summary of the facts as they were explained to us by the representative for the Taxpayer.

The Taxpayer was a subsidiary of a United Kingdom company based in London and was part of a worldwide group of companies which promoted and sold throughout the world a famous brand of consumer products. The Taxpayer was a company incorporated and based in Hong Kong. It employed a number of sales staff who were based in Hong Kong and who were required to travel round Asia promoting and selling the group products on behalf of the Taxpayer. The countries to which the Taxpayer sold the group products included most of the countries in the Asia Pacific region with Japan being one of the largest markets not only in Asia but in the world.

The modus operandi was for the worldwide business of the group to be controlled by the parent company in London. A new line or range of products would be decided in London and sourced from factories in various European countries. These products would then be sold worldwide with the Taxpayer handling sales in the Asia Pacific region. The salesmen based in Hong Kong would visit potential customers in the region and sell products to them. There were a comparatively small number of large customers to whom the Taxpayer sold the products.

When the Taxpayer purchased goods from the factories it did so in the foreign currency of the country where the factory was located. When goods were sold they were likewise sold in the foreign currency of the country where the purchaser was located. Prices were decided by the parent company in London on a worldwide basis.

The goods were physically handled in one of three ways. The Taxpayer appointed a freight forwarder in Europe to take delivery of the goods on it behalf. Then in some cases the customer would have its own freight forwarder in Europe to whom the goods would be delivered; or in other cases the freight forwarder of the Taxpayer in Europe would

despatch the goods and deliver them to the customer in the customer's own country. The third method was for the freight forwarder in Europe to send the goods to Hong Kong where the same were delivered to another freight forwarder also acting as agent for the Taxpayer who then on delivered the same to the customer in the foreign country. The third way meant that the goods were transhipped through Hong Kong by the Taxpayer.

The salesmen employed by the Taxpayer who visited customers in the region were empowered to sell products for the Taxpayer when they were promoting the same.

After the representative for the Taxpayer had explained the facts with regard to the trading transactions to the Board, Mr Wu, Crown Counsel, representing the Commissioner was asked to address the Board. He confirmed that the Commissioner had agreed to compromise the case and confirmed that the facts explained to the Board by the representative for the Taxpayer were correct so far as he was concerned. He confirmed that so far as the Commissioner was concerned the Commissioner accepted that with the exception of those products which were physically transhipped through Hong Kong the profits did not arise in nor derived from Hong Kong.

The Board informed Mr Wu that it had some difficulty in understanding the case because of the recent High Court decision, CIR v Euro Tech (Far East) Limited (not yet reported). The Board noted that Mr Wu had been the Crown Counsel who represented the Commissioner in the Euro Tech case and that Mr So who was the senior assessor instructing Mr Wu had been the representative for the Commissioner who had originally appeared representing the Commissioner before the Board of Review when the Euro Tech case was heard by the Board of Review. It was pointed out or Mr Wu that the facts of this case appeared to have some similarity with those of the Euro Tech case and the Board asked Crown Counsel to explain why the Commissioner took a different view in the two cases with regard to the place where the profit arose. Crown Counsel produced before the Board a document stated to be a confirmation of an order which had been issued to the Taxpayer by one of the customers of the Taxpayer and drew the attention of the Board to a signature by one of the salesmen of the Taxpayer confirming the sale was made outside of Hong Kong. He said that the decision of the Commissioner was based on this document as being typical.

The Board then took the opportunity to ask Mr Wu for his assistance with regard to the statement made by Barnett J in the Euro Tech case namely:

> *'I was also informed from the bar, on instructions, that the Commissioner commonly agrees that profits are not chargeable to tax if they fall into one of 3 categories namely, (1) interest on deposits outside Hong Kong, (2) provision of a service or services outside Hong Kong or (3) the development of land outside Hong Kong.'*

The Board explained that it had some difficulty in the present case because apparently neither Mr Wu nor Barnett J had made any reference to the possibility of trading profits arising outside of Hong Kong. Mr Wu explained that it had not been necessary to

mention such cases in the Euro Tech cases because the Euro Tech case was itself a trading case.

The Board then asked as to the distinction to be drawn between the case before it and the Exxon case (Exxon Chemical International Supply SA v CIR 3 HKTC 57) which the Board had been directed to consider by the learned judge in the Euro Tech case. Mr Wu said that the cases could be distinguished.

Prior to the Euro Tech case the Board would have had no difficulty whatsoever in accepting the compromise agreement which was tabled before it. With some hesitation we have decided on the basis of the submissions made before us that this case can and should be distinguished from both the Euro Tech decision and the Exxon decision and accordingly have decided that the compromise agreement tabled before us is acceptable.

Accordingly the Board orders that the assessments against which the Taxpayer has appealed should be revised in accordance with the terms of the compromise agreement tabled before us.