Case No. D47/93

Profits tax – trading or document handling company – whether profit arises in or is derived from Hong Kong.

Panel: Ronny Wong Fook Hum QC (chairman), Robert Kwok Chin Kung and Larry Kwok Lam Kwong.

Dates of hearing: 25, 26 October and 1 November 1993.
Date of decision: 21 December 1993.

The taxpayer claimed that its business comprised the sale and purchase of products and that the profits from such business did not arise in nor were derived from Hong Kong. The Commissioner did not accept this and the taxpayer appealed to the Board of Review.

Held:

On the evidence before it the Board was satisfied that the true business of the taxpayer was the facilitation of the sale and purchase of products in the context of the US anti-dumping law. The taxpayer completed the necessary documents in Hong Kong to perform this service. These acts were performed in Hong Kong and were crucial to the generation of the profits which the taxpayer received. Accordingly the income arose in and was derived from Hong Kong.

Appeal dismissed.

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

Cases referred to:

Edwards v 'Old Bushmills' Distillery 10 TC 285
Inland Revenue Commissioners v Sneath [1932] 2 KB 362
CIR v Hang Seng Bank Limited [1991] 1 AC 306
CIR v HK-TVB International Limited [1992] 3 WLR 439
Sinolink Overseas Ltd v CIR 2 HKTC 127
D59/92, IRBRD, vol 8, 63

Jennifer Chan for the Commissioner of Inland Revenue.
Denis O'Dwyer of Messrs Ernst & Young for the taxpayer.

Decision:

I. BACKGROUND OF THIS CASE

1. We are concerned with the Taxpayer's liability to profits tax for the years of assessment 1981/82 to 1986/87. The hearing before us was the second visit by the Taxpayer to the Board of Review.

2. The Taxpayer's first visit to the Board of Review took place in 1986. The Taxpayer objected to the assessor's refusal to correct under section 70A the profits tax assessments for the years of assessment 1978/79 and 1979/80 and the profits tax assessment for the year of assessment 1980/81 on the grounds that the profits in those years did not arise in or were not derived from Hong Kong and it should not be liable to Hong Kong profits tax.

3. The matter was heard by a differently constituted Board of Review. After hearing evidence (including that from a Mr A of the Taxpayer) the Board by its decision dated 9 September 1986 ['the 1986 Decision'] rejected the Taxpayer's contentions.

4. The Taxpayer challenged the 1986 Decision by requiring the Board of Review to state a case for consideration by the High Court pursuant to section 69 of the Inland Revenue Ordinance. The Taxpayer's appeal was scheduled to be heard on 25 November 1991. On 8 November 1991, the Taxpayer advised the Revenue that it would not pursue the appeal.

II. CONDUCT OF THE HEARING BEFORE US

1. Both the Revenue and the Taxpayer accepted the primary facts as set out in the 1986 Decision. The only new evidence tendered by the Taxpayer is an affidavit of Mr A dated 20 October 1993. Mr A states as follows:

> 'I was closely involved with the operations of [the Taxpayer] from the date of its incorporation and I confirm that the method of operation of [the Taxpayer] up to (and beyond) 31 December 1986 was the same as for the period up to 31 December 1980. In particular I would confirm that I have read the decision of the Board of Review dated 9 September 1986. The arrangements relating to [X Co] outlined therein continued up to and beyond 31 December 1986 and the transaction is a representative transaction. It is also representative of the manner in which [the Taxpayer] operated. I would confirm that the basis of operation remained unchanged during all years under review (that is up to and including the year ended 31 December 1986).'

2. The Taxpayer's representative (who conducted the Taxpayer's case throughout with skill and care) accepted that at the material times the Taxpayer was carrying on a business in Hong Kong but argued that the Taxpayer's profits did not arise in Hong Kong. It should be noted that the 'business' of the Taxpayer as accepted before us was in the buying and selling of products. The Taxpayer did not accept the finding of the previous Board that its true 'business' was in 'producing documentation which met the satisfaction and procurement requirements'. The Taxpayer emphasised that the commercial activities of the Taxpayer as set out in the 1986 Decision indicate that the buying and selling of products were conducted predominantly outside Hong Kong.

3. The Revenue placed no reliance on the principle of res judicata. At the invitation of this Board, the Taxpayer's representative assisted us on the operation of this doctrine. We find the following statements of principle helpful:

   (a) In Edwards v 'Old Bushmills' Distillery 10 TC 285 at 299 Viscount Cave stated that:

   > 'My Lords, I agree that the Commissioners were not bound by the decision of the recorder in respect of the year 1920/21 to discharge the assessment for the year 1921/22. The facts in the latter year may have been, and to some extent were, different and I think the Commissioners should have gone into the facts and arrived at their own conclusion.'

   (b) In Inland Revenue Commissioners v Sneath [1932] 2 KB 362 at 383 Lord Hanworth MR took the view that:

   > 'I am, therefore, of opinion that the assessment is final and conclusive between the parties only in relation to the assessment for the particular year for which it is made. No doubt a decision reached in one year would be a cogent factor in the determination of a similar point in the following year, but I cannot think that it is to be treated as an estoppel binding upon the same party for all years.'

4. The Taxpayer contended that what was decided by the previous Board was not an issue of fact but an issue of law or mixed law and fact. The Taxpayer further argued that what was decided was not 'the same issue' because the law has since been clarified by the decisions of the Privy Council in CIR v Hang Seng Bank Limited [1991] 1 AC 306 and CIR v HK-TVB International Limited [1992] 3 WLR 439

III. EFFECT OF THE RECENT PRIVY COUNCIL DECISIONS

1. Sinolink Overseas Ltd v CIR 2 HKTC 127 was cited to the previous Board. The previous Board took the view that Mr Justice Hunter was not attempting in Sinolink 'to lay down tests to be applied in all circumstances'. The previous Board drew attention to the remarks of Mr Justice Hunter that 'I do not regard the factual weight which one court may give to a particular factor in the case before it, as of any guide to any subsequent court, except possibly where the facts as a whole are not indistinguishable …' The previous Board reached its decision by adopting 2 different approaches:

   (a) The previous Board stated that:

   > 'It would seem that [the Taxpayer] took on a chameleon-like role adopting the appropriate colour for the background against which it was to be viewed. We see [the Taxpayer's] function was to fulfil certain roles for its shareholders that is satisfy the US Customs and procure D/P terms: conceivably [the Taxpayer] also mitigated US taxes for its shareholders. Which of the first two roles was the more important we do not propose to speculate.
   >
   > It is our view that the first two roles were [the Taxpayer's] true 'business' that is producing documentation which met the satisfaction and procurement requirements. That business was its vital function, the pivot upon which the success of the scheme of the consortium depended. These roles constituting that business perforce were carried out in Hong Kong and [the Taxpayer] was rewarded (for conducting itself in such a manner that these roles were satisfactorily fulfilled) by receiving, into its Hong Kong bank account, the difference between the price paid by [X Co] and the price payable to it by the consortium members.'

   (b) Alternatively, the previous Board stated that:

   > 'If however we are wrong to approach the subject in this manner and ought to confine ourselves to determining whether (a) a business, other than that as described above, was carried on in Hong Kong, or (b) a profit was derived in Hong Kong, we are inclined to the opinion that in this case [the Taxpayer] was carrying on business in Hong Kong because the roles performed by [Mr B] and [Miss C] on behalf of [the Taxpayer], even if mechanical, were truly

> operational roles and were the causa causans from which the profit arose ...
>
> Expressed in another way, one of [the Taxpayer's] roles was to provide invoices at prices at or above the anti-dumping minima to the US Customs and those invoices necessarily had to come from [the Taxpayer] in Hong Kong ...'

2. In CIR v Hang Seng Bank Ltd Lord Bridge stated that:

> '… But 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. It is impossible to lay down precise rules of law by which the answer to that question is to be determined. 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. If he has rendered a service or engaged in an activity such as the manufacture of goods, the profit will have arisen or derived from the place where the service was rendered or the profit making activity carried on. But if the profit was earned by the exploitation of property assets as by letting property, lending money or dealing in commodities or securities by buying and reselling at a profit, the profit will have arisen in or derived from the place where the property was let, the money was lent or the contracts of purchase and sale were effected.'

3. In CIR v HK-TVB International Limited Lord Jauncey expressed the view that 'it is a mistake to try and find an analogy between the facts in this appeal and the example given by Lord Bridge in the Hang Seng Bank case. The circumstances in that case involving, as they did, buying and selling in well-defined foreign markets were very different from those in the present and the examples were never intended to be exhaustive of all situations in which section 14 of the Ordinance might have to be considered. The proper approach is to ascertain what were the operations which produced the relevant profits and where those operations took place'.

4. We are of the view that the decision of the previous Board is wholly consistent with these authorities. They set out in the 1986 Decision their views as to what the Taxpayer did to earn the profit in question. They further set out as an alternative in the 1986 Decision their conclusions on application of the operations test. The 2 subsequent Privy Council authorities do not dictate a departure from the 1986 Decision.

IV. OUR CONCLUSIONS

1. The previous Board had the benefit of seeing and reading the primary evidence. They came to the conclusion that the Taxpayer's true 'business' was in 'producing documentation which met the satisfaction and procurement requirements'. They took the view that one of the Taxpayer's roles was 'to provide invoices at prices at or above the anti-dumping minima to the US Customs and those invoices necessarily had to come from [the Taxpayer] in Hong Kong'. These are the features which distinguish the present case from D59/92, IRBRD, vol 8, 63.

2. On the basis of the facts as set out in the 1986 Decision, we take the view that the business of the Taxpayer in the relevant tax years did not consist merely of sale and purchase of products. Its true business was the facilitation of sale and purchase of products in the context of the US anti-dumping laws. The completion by the Taxpayer in Hong Kong of the 'special summary invoice' and the 'special customs invoice' addressed to the US Customs Department of the US Treasury were operations vital to the success of the whole scheme. Those acts performed in Hong Kong were crucial to the generation of the profits which the Taxpayer received into its Hong Kong bank account.

3. No new fact has been drawn to our attention. We are not prepared to differ from the finding of the previous Board and would accordingly dismiss the appeal and confirm the profits tax assessments for the years of assessment 1981/82 to 1986/87 inclusive.