Case No. D51/97

Profits tax – source of profit – import/export business – purchase of goods in Hong Kong with sale of goods to overseas customer negotiated by overseas agent – related sales activities, including processing of customer's order, carried out both in and outside Hong Kong – Inland Revenue Ordinance section 14(1).

Panel: Andrew Halkyard (chairman), Anna Chow Suk Han and Shirley Conway.

Date of hearing: 20 May 1997.
Date of decision: 15 September 1997.

Prior to the year of assessment 1992/93 the controller of the Taxpayer, a Hong Kong company, had established contacts with an offshore supplier and an offshore customer for the purchase and sale of chemicals for use in the mining industry.

During the year of assessment the following transaction took place. The Taxpayer purchased chemicals from the supplier through its office in Hong Kong. The Taxpayer sold the chemicals to the customer under a contract negotiated by its offshore agent who was stationed in the same country as the customer. Upon negotiating the order, the customer informed the Taxpayer of the purchase order number. The evidence relating to the actual conclusion of the contract was incomplete (for example, the purchase order was not available and there was no evidence as to where the terms of sale acceptable to the Taxpayer were discussed and agreed with the agent).

Various other transactions also took place giving rise to profits. These transactions involved purchasing chemicals from the supplier and selling those chemicals to other offshore mining companies. No document was produced to the Board evidencing these transactions. The offshore agent was not involved in these transactions. The Commissioner was not satisfied that the transaction described in the previous paragraph was representative of these remaining transactions.

The Taxpayer claimed, relying upon Magna Industrial Co Ltd v CIR [1996] IRBRD, vol 11, 600 that all its profits were derived from a source outside Hong Kong and were thus not chargeable to profits tax.

Held:

(1) What activity produced the profits in dispute? In relation to the first transaction, and considering the totality of facts, the activity producing the Taxpayer's gross profits from trading included: the negotiations leading to, and

conclusion of, the contract for sale to the mining company, including the agreement reached with the agent as to the terms of sale acceptable to the Taxpayer; and the negotiations leading to, and the conclusion of, the contract for purchase of the goods from the supplier, including the subsequent processing by the Taxpayer of the order from the mining company.

Where was this activity done? In relation to the sale the evidence was unclear. However, on the basis of the facts found it could be inferred that relevant activity took place both in and outside Hong Kong. In relation to the purchase all the Taxpayer's dealings with the supplier took place in Hong Kong and the contract was concluded in Hong Kong. Moreover, the subsequent processing of the order from the mining company by the Taxpayer took place in Hong Kong. In the result, a very high preponderance of profit-earning activity of the Taxpayer took place in Hong Kong. Accordingly, the Taxpayer's profit from this transaction arose in Hong Kong and was liable to profits tax (Magna Industrial Co Ltd v CIR considered).

(2) Turning to the remaining transactions, the picture was even murkier. In the absence of detailed evidence, and bearing in mind that the Commissioner did not accept that the transaction described above was representative, the Taxpayer had not discharged its onus of showing that the profits from these transactions arose outside Hong Kong.

Appeal dismissed.

Cases referred to:

CIR v Hang Seng Bank Ltd (1990) 3 HKTC 351 at 360
CIT (Bombay and Aden) v Mehta (1938) LR 65 LA 332
HK-TVB International Ltd v CIR (1992) 3 HKTC 468 at 477
Magna Industrial Co Ltd v CIR [1996] IRBRD, vol 11, 600
Nathan v FCT (1918) 25 CLR 183 at 189-190

Tse Yuk Yip for the Commissioner of Inland Revenue.
Taxpayer represented by its director.

Decision:

The Taxpayer has appealed against the Commissioner's determination disallowing its objection to the profits tax assessment for the year of assessment 1992/93 raised on it. The Taxpayer claims that its profits arise in or are derived from outside Hong Kong and are thus not subject to profits tax.

The facts

The following facts are not in dispute.

1. The Taxpayer was incorporated in Hong Kong on 18 October 1985 and commenced business on 6 November 1985. In its application for business registration, the Taxpayer declared the nature of its business as 'import/export'. At all relevant times, the business address of the Taxpayer was in District A.

2. The Taxpayer's profits tax return for the year of assessment 1992/93 and accompanying financial accounts for the year ended 30 April 1992 showed the following gross profit from sales:

Sales	$2,156,248
Less: Cost of sales	1,416,203
Gross profit	$ 740,045

According to its accounts, the Taxpayer's net profit before taxation was $335,414 and its major expenses were: 'Commission' $171,600. 'Overseas travelling and accommodation' $102,859, 'Staff salaries' $93,600 and 'Telephone, telex and fax' $55,855. The Taxpayer claimed that all its transactions in the year of assessment resulted in offshore profits and were thus not chargeable to profits tax.

3. In connection with the Taxpayer's offshore profits claim, Mr C, a director, advised the assessor as follows in relation to a transaction involving a mining company, Company B:

(a) 'I have been going to Country D to sell chemicals to the mining sector since 1982. I have visited the head office in Country D; I have also visited the mine, which is a whole days journey from Country D. In this way I have built up a relationship with [Company B]. In the case of this transaction I had also made good contact with a Mr E of Company F in Country D. Mr E is a long term resident of Country D. Mr E has excellent contacts with Company B: many of the executives of [Company B] went to school with Mr E. The sale was made with the help of Mr E to whom we paid commission.'

(b) 'Starting in 1982 I have visited Country G ... on numerous occasions in order to buy chemicals. I have built up relations with [a state enterprise in Country G]. This is the organization handling export sales of chemicals from Country G ... For ease of handling business, they recently opened an office in Hongkong.'

(c) 'While most of the negotiation with the Country G Government and [the state enterprise in Country G] did take place in Country G in previous years the actual purchase agreement was signed [by me] in Hongkong.'

(d) 'When we got the order from Company B we made a contract dated 30 September 1991 with [Company I]. Subsequently we received a letter of

credit ... from Company B and were able successfully to negotiate this letter of credit and obtain the funds.'

4. Mr C also submitted to the assessor certain documents relating to the purchase of 400 MT of sodium sulphide ('the Goods') from Company I and its sale to Company B. The following narrative can be gleaned from those documents.

(a) On 27 September 1991 Company B issued a proforma invoice to purchase the Goods from the Taxpayer.

(b) On 30 September 1991 Company F transmitted a fax to the Taxpayer which stated: 'Following is the official order of Company B for [the Goods]. The letter of credit is now in process.'

(c) On 30 September 1991 the Taxpayer sent a purchase order for the Goods by 'fax and mail' to Company I at Hong Kong. The purchase order stated that the Goods were to be delivered 'C & F Country D'. It was signed by Mr C on behalf of the Taxpayer and confirmed and accepted by Company I in Hong Kong.

(d) On 7 October 1991 a contract was issued by Company I to the Taxpayer showing Company I as the seller and the Taxpayer as the buyer of the Goods.

(e) On 10 October 1991 an irrevocable letter of credit was issued by Bank J at the request of Company B in favour of the Taxpayer in the amount of US$156,000.

(f) Before 17 October 1991 the Taxpayer applied to Bank K to issue an irrevocable letter of credit in favour of Company I in the amount of US$114,460. The letter of credit was issued by the bank on 17 October 1991.

(g) Company I arranged for shipment of the Goods. Copies of the bill of lading and packing list dated 15 December 1991 were sent by Company I to the Taxpayer showing that the Goods were shipped from Country G for delivery to Company B in Country D.

(h) On 16 December 1991 Company I issued an invoice to the Taxpayer for the Goods in the amount of US$114,460.

(i) On 16 December 1991 the Taxpayer issued an invoice to Company I for shortage of Goods supplied in the amount of US$786.

(j) On 19 December 1991 the Taxpayer issued an invoice to Company B for the Goods in the amount of US$156,000. A packing list prepared by the Taxpayer was sent to Company B at the same time.

(k) On 13 January 1992 Company F received US$22,000 from the Taxpayer as commission for the transaction.

5. In response to the assessor's enquiries the Taxpayer made the following assertions relating to the role of Mr E referred to at fact 3(a):

> '(a) Mr E [of Company F] was our agent for selling to Company B. His duties were to contact the customer in all ways possible so as to get the order and to facilitate the order's smooth passage: this included calling on the purchase manager: discussing with [the] purchase manager's staff: entertaining members of the staff of Company B: passing on to us Company B's requirements: trying to find out any information on competitors: facilitating the issue of letters of credit by Company B: overcoming any problems due to late delivery or missing bags of product: other assorted work as it became necessary.
>
> (b) The agreement whereby Mr E [of Company F] acted as our selling agent was the result of a series of faxes exchanged between us: these ended with the fax from Mr E dated 30 September 1991 [fact 4(b) refers].'

6. According to its application for business registration, Company I was incorporated in Hong Kong on 9 May 1986.

7. The assessor considered that the Taxpayer's profits were chargeable to profits tax and raised the following assessment on the Taxpayer for the year of assessment 1992/93:

Profit per accounts	$335,414
Less: Loss carried forward	39,705
Net assessable profits	$295,709
Tax payable	$ 51,749

8. The Taxpayer objected to the assessment on the ground that all its profits were based on transactions taking place wholly outside Hong Kong and were thus not liable to profits tax.

9. Apart from the documentation and information set out in relation to the Company B transaction described at facts 3 – 5, the Taxpayer did not provide any information in respect of the remaining transactions claimed to be offshore in nature. This was so despite a request from the assessor to provide a breakdown of the total sales and cost of sales for the year.

10. On 18 April 1996 the Commissioner disallowed the Taxpayer's objection and confirmed the assessment set out at fact 7.

11. On 30 April 1996 the Taxpayer appealed to the Board of Review against the Commissioner's determination.

12. The assessor's request for further information from the Taxpayer (fact 9 refers) was repeated by the assessor (Appeals) on 4 February 1997. The Taxpayer did not respond to this request.

13. On 13 March 1997 the assessor (Appeals) requested the Taxpayer to provide a breakdown of its claims "Overseas travelling and accommodation' $102,859 and 'Staff salaries' $93,600. The Taxpayer did not respond to this request.

The proceedings before the Board

Mr C, representing the Taxpayer, appeared before us and elected to give sworn evidence. On the basis of Mr C's testimony we find the following additional facts.

14. Mr C is the controller and sole active director of the Taxpayer. He has 28 years of trading experience in Hong Kong. Since the early 1980s he has travelled extensively to Country G, to source products for use in the mining industry in Country D and Country L, countries to which he also travelled extensively.

<u>The purchase from Company I</u>

15. Mr C originally made contact in Country G with the state enterprise which now controls Company I. Subsequently, that enterprise decided to open an office in Hong Kong. Company I was then incorporated in Hong Kong (fact 6 refers). For the Company B transaction described above (facts 3 – 5 refer), all dealings with Company I took place through its office in Hong Kong. The Goods were, however, sourced from Country G. Mr C gave evidence that, on occasions, an employee of the Taxpayer visited the factory premises in Country G and the port of shipment to check if the packing and quality of the product were satisfactory. In this regard, however, his evidence was very general. In the absence of the information requested at fact 13 we cannot find as fact that such activity actually occurred in relation to the Company B transaction.

<u>The sale to Company B and the role of Mr E</u>

16. Prior to the sale of Mr C visited Company B in Country D on several occasions and established a relationship with that company. The particular contract was, however, negotiated in Country D by Mr E of Company F on behalf of the Taxpayer. The relationship between the Taxpayer and Mr E was also established as a result of Mr C's trips to Country D although contact was maintained with Mr E by Mr C from Hong Kong. Before this negotiation took place, Mr C gave Mr F guidelines and general direction as to quality, price, delivery and tonnage availability of the goods. Thereafter, in the words of Mr C, 'Mr E had permission to make a deal'.

17. After the negotiation was completed between Mr E and Company B, no formal contract of sale and purchase for the goods was prepared. Company B simply informed the Taxpayer of its purchase order number. This was followed by a formal purchase order from

Company B which was communicated by Company F to the Taxpayer.[1] Mr C explained the import of these actions as follows: 'I believe the fact that [Company B] issued a letter of credit to us is evidence that they contracted as a letter of credit is a contractual document. If you accept a letter of credit and act on it, an offer an acceptance. So, it seems to me that they effectively made an offer to us. We accepted it by supplying to them.'

18. There was no written agency agreement entered into between the Taxpayer and Mr E or Company F. The commission paid to Company F was computed as follows. Mr C and Mr E agreed a price at which the Taxpayer would be willing to sell and if Mr E could get a better price from Company B then his company, Company F, would be able to keep the difference as its profit. From this difference, or commission, Company F would be expected to pay various costs incurred in Country D, including a special tax levied by Country D Government on imports from Country G.

The remaining sales for 1992/93

19. Apart from the sale to Company B the remaining transactions entered into by the Taxpayer for the year of assessment 1992/93 followed a similar pattern. Specifically, mining consumable supplies were sourced from suppliers in Country G and sold to mining companies in Country L. How the individual transactions (some three or four in total) were effected was not made clear by Mr C's evidence other than his statement that he had travelled to Country G and Country L on various occasions and spent a good deal of effort at developing good business relationships between the Taxpayer and the Country G supplier as well as between the Taxpayer and Country L's mining companies. Mr C could not say for certain whether he and other staff of the Taxpayer travelled to Country L during 1992 (but he thought this should have been the case). Mr E played no role in these transactions and no commission was paid in respect thereof.

20. When reminded that the assessor had, prior to the Board hearing, asked for details of staff and travel expenses (fact 13 refers), Mr C stated that he had not replied to the request because producing all the details for 1992/93 was unreasonable and oppressive. He recalled however that in 1992 the Taxpayer employed two staff, Mr M and Mr N. Mr C stated that the job of both these gentlemen involved travelling to Country G, Country D and Country L to further the Taxpayer's business. It was not clear from Mr C's evidence how often these gentlemen travelled overseas (we infer they were based in Hong Kong) and what the *precise* nature of their work for the Taxpayer was whilst they were in and outside Hong Kong.

21. The diverse nature of the transactions is illustrated by Mr C's evidence '[The transactions] involved travelling to Country L and seeing the mines and trying to get them to try the product and trying to get Country G suppliers to supply them properly and a great deal of work had to be expended in both places in order to make it work. ... We had been

[1] There is no evidence before us as to when Mr E actually carried on negotiations with Company B. Furthermore, the Taxpayer did not produce the proforma invoice (fact 4(a) refers). Nor did we see the formal purchase order. This latter document was simply referred to in Company F's fax to the Taxpayer dated 30 September 1991 (fact 4(b) refers).

talking to the mining companies for several years in advance of [the transactions] and that the results shown in the year ended 30 April 1992 were the result of work done perhaps even in the 1980s and which produced profit in that particular financial year. But the detail of the actual purchase was a result of something initiated perhaps at the time by a visit or a telephone call. ... And the period of preparation is over some years, usually.'

The work performed by Mr C in Hong Kong

22. As was the case of the Taxpayer's employees, there is no evidence before us as to the precise details of Mr C's absences from Hong Kong. However, while he was present in Hong Kong Mr C controlled the business of the Taxpayer (he was the sole active director), he liaised with Mr E, he handled the work relating to the various letters of credit which the Taxpayer opened as well as those in which it was named as the beneficiary, and was the ultimate arbiter if any dispute arose.

Failure to answer the assessor's queries

The Taxpayer did not answer all the assessor's queries (facts 9, 12 and 13 refer). In cross-examination, Mr C considered that the Taxpayer's dispute with the Commissioner was a small one, that he did not have staff to answer all the questions and that he could not afford the time or the money to answer them. In essence, however, Mr C contended that the transaction with Company B was representative and that he had provided the assessor with documentation concerning this transaction. In any event, Mr C considered this dispute to involve a direct challenge to Departmental Interpretation and Practice Notes No 21 which states that if *either* the sale contract *or* purchase contract was effected in Hong Kong then the profits from that transaction would be located in Hong Kong.[2] If this view was correct then, according to Mr C, the Taxpayer's profits would be taxable because the contracts of purchase from Company I were all effected in Hong Kong and any extra documentation and information he could supply would not alter this conclusion.

The Taxpayer's contentions

The Taxpayer was represented at the hearing by Mr C. He claimed that all the Taxpayer's profits arose outside Hong Kong.

Mr C accepted that the Taxpayer's purchase contract with Company I (facts 3 and 4 refer) was executed in Hong Kong. However, he noted that this was only a convenience and that the purchase arose from a long-term relationship with Country G which mostly took place outside Hong Kong. To the extent that the purchasing activity was significant to this appeal, Mr C asked us to look at the totality of facts, including the establishment and nurturing of the relationship with Company I.

In any event, Mr C requested us to overturn the Commissioner's views on the locality of profits, specifically, the statement in Departmental Interpretation and Practice

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[2] See paragraph 7(c) of the 1992 version of the Practice Note.

Notes no 21 that 'Where either the contract of purchase or contract of sale is effected in Hong Kong, the profits will be fully taxable.' Mr C argued that the Departmental practice, which focused upon the place of signing the contract, was too rigid and not in accordance with binding case law.

Turning to the sale to Company B, Mr C argued that the sale was made by the Taxpayer's agent in Country D, Mr E of Company F. In this regard, Mr C denied that Mr E was acting as a middlemen between the Taxpayer and Company B. According to Mr C, his function was similar to a salesman and involved negotiating with Company B and obtaining an order on the Taxpayer's behalf. Mr C noted that Company F was paid a commission (fact 4(k) refers) and that payment of commission would not be appropriate if the relationship between the Taxpayer and Company F was not one of agency.

Mr C then referred to his oral evidence and reminded us that Mr E did make the sale to Company B in Country D and that, in accordance with standard mining company practice, Company B accepted the Goods offered by simply sending a purchase order to the Taxpayer. In other words, Mr C argued that the order evidenced the sale and the sale was effected at the place where the order originated.

Apart from referring us to certain cases establishing general principles in interpreting section 14, namely, CIR v Hang Seng Bank Ltd (1990) 3 HKTC 351 and CIT (Bombay and Aden) v Mehta (1938) LR 65 LA 332, Mr C relied upon the following statement in HK-TVB International Ltd v CIR (1992) 3 HKTC 468 at 477 where the Hang Seng Bank case was explained as follows:

> *In the Hang Seng Bank case the two transactions which threw up the profit, namely the purchase and re-sale of the certificates of deposit, both took place outside Hong Kong and this Board held that the profits did not arise in or derive from Hong Kong, notwithstanding the fact that all the instructions to buy and sell originated in Hong Kong and that there was no independent branch office interposed between the head office in Hong Kong and the following transactions.'*

In Mr C's submission, the Taxpayer's case was even stronger than that of the Hang Seng Bank because, unlike the Hang Seng Bank case, extensive travelling took place outside Hong Kong and much more activity was performed overseas, such as the various operations carried out by the Taxpayer in Country G, Country D and Country L.

Finally, Mr C drew an analogy between the Taxpayer's case and Magna Industrial Co Ltd v CIR [1996] IRBRD, vol 11, 600 where the Taxpayer's trading profits were held not to be taxable. Mr C argued that, unlike the Magna Industrial case, the goods never came to Hong Kong; and thus the Taxpayer's case for deriving offshore profits was even more compelling. Mr C contended that the Magna Industrial case has many similarities with the Taxpayer's appeal and suggested that it was a strong precedent in the Taxpayer's favour.

The Commissioner's contentions

Citing the Hang Seng Bank case, the Commissioner argued that the present appeal involved dealing in goods, the profit from which arises where the contracts of purchase and sale were effected. The Commissioner contended that the contracts of purchase and sale in this appeal were all effected in Hong Kong.

In the context of Company B's transaction, the Commissioner relied upon the law of offer and acceptance to the effect that the contracts were concluded in Hong Kong. Specifically in relation to the contract of sale, the Commissioner refused to accept that Company F, through Mr E, acted as the Taxpayer's agent and noted that the evidence simply shows that the formal order was communicated by Company B to the Taxpayer in Hong Kong and was accepted here and that on the same date the Taxpayer placed an order with Company I for the goods. Given that Company F was entitled to keep the difference between the price agreed with the Taxpayer and the amount actually paid by Company B, the Commissioner argued that Company F and the Taxpayer were simply acting on a principal to principal basis and, therefore, any activity of Mr E in relation to the sale was irrelevant to determining the source of the Taxpayer's profits.

In any event, the Commissioner argued that, looking at the totality of facts, all necessary acts in the arranging and carrying out of the purchase and sale giving rise to the profit derived from the Company B's transaction were done in Hong Kong.

In relation to the transactions other than the Company B's transaction, the Commissioner contended that, in the absence of detailed information, there is simply insufficient evidence for the Taxpayer to satisfy the burden placed upon it to show that its profits were derived outside Hong Kong.

The relevant law

The statutory framework. Section 14(1) of the Inland Revenue Ordinance (the IRO) is the general charging provision to profits tax. It seeks to tax 'profits arising in or derived from Hong Kong'. Section 2(1) defines 'profits arising in or derived from Hong Kong' to include 'all profits from business transacted in Hong Kong, whether directly or through an agent'.

Case law. The broad principles which should generally be applied in determining the source of profits have been set out in decisions of superior courts binding upon this Board. They were not in dispute in this appeal and can be summarised as follows.

(1) The question of locality of profits is a practical, hard matter of fact (Nathan v FCT [1918] 25 CLR 183 at 189-190).

(2) The leading case, and one that establishes the general principle to be followed, is CIR v Hang Seng Bank Ltd. In that case Lord Bridge, delivering the decision of the Privy Council, stated at (1990) 3 HKTC 351 at 360:

'The question whether the gross profit arising 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 ... the profit was earned by ... 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 contracts of purchase and sale were effected.' (compare Magna Industrial Co Ltd v CIR (1996) IRBRD, vol 11, 600)

In HK-TVB International Ltd v CIR (1992) 3 HKTC 468, Lord Jauncey, in delivering the decision of the Privy Council, stated at 477:

'Lord Bridge's guiding principle [set out in the Hang Seng Bank case] could properly be expanded to read: 'One looks to see what the taxpayer has done to earn the profit in question and where he has done it'. Further, their Lordships have no doubt that when Lord Bridge, after quoting the guiding principle, gave certain examples he was not intending thereby to lay down an exhaustive list of tests to be applied in all cases in determining whether or not profits arose in or were derived from Hong Kong.'

(3) The distinction between Hong Kong profits and offshore profits is made by reference to gross profits arising from individual transactions (Hang Seng Bank case at 359).

(4) In relation to the source of trading profits, it is necessary to examine the totality of relevant facts to find out what the taxpayer has done to earn the profit. The Court of Appeal specifically approved this approach which was adopted by the Board of Review in Magna Industrial. At 603 Litton VP, delivering the judgment of the Court of Appeal, stated:

> *'This was, in essence, the Board of Review's approach. At paragraph 7.23 of the stated case the Board said:*
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> > *"This is a case of a trading profit and the purchase and the sale are the important factors. We place on record that we have included in our deliberations all of the relevant facts and not just the purchase and sale of the products. Clearly everything must be weighed by a Board when reaching its factual decision as to the true source of the profit. We must look at the totality of the facts and find out what the taxpayer did to earn the profit."*
>
> *No criticism can be made of this approach.'*

The Court of Appeal then gave some examples of the facts relevant to determining the source of trading profits:

> *'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 the payment effected?'*

(5) The absence of an overseas establishment does not, of itself, mean that all the profits of that business arise in or are derived from Hong Kong (Hang Seng Bank case at 355). However, in the HK-TVB International case Lord Jauncey stated at 480:

> *'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 under section 14 of the Inland Revenue Ordinance.'*

In the Magna Industrial case Litton VP stated at 607:

> *'As a matter of common-sense, this must be so.'*

Analysis

The principles which we must apply in this case are clear although, on occasions, their application in a complex commercial world is not. In this appeal, however, such difficulties have been compounded by the Taxpayer's failure to respond to the assessor's enquiries. We will return to this matter later.

Our clear task is that we must first identify what transaction or business activity produced the profits and then look to see where this was done (CIR v Hang Seng Bank Ltd and HK-TVB International Ltd v CIR). In this regard, we must look at the activity which produced the gross profits in relation to individual transactions (CIR v Hang Seng Bank Ltd). The computation of the gross profit in this case is set out at fact 2: it is simply sales less the cost of sales.

Company B's transaction

Turning first to Company B's transaction, and considering the totality of the facts before us, the activity producing the Taxpayer's gross profits from trading include the following:

(1) The negotiations leading to, and the conclusion of, the contract for sale of the goods to Company B, including the agreement reached with Mr E as to the terms of sale acceptable to the Taxpayer.

(2) The negotiations leading to, and the conclusion of, the contract for purchase of the goods from Company I, including the processing of the order from Company B by the Taxpayer.

Like the Board of Review in Magna Industrial (at 610), we considered that the sale and purchase elements of this transaction were the most material to earning the profit in dispute. Other elements, such as negotiating and opening letters of credit by the Taxpayer for receiving and paying the sale and purchase price of the goods, were also relevant. Conversely, matters such as issuing an invoice, the place of making and collecting payment, and issuing a packing list were merely ancillary to deriving the relevant profit; while other matters, such as packing, storage and shipment of the goods, were handled by Company I who dealt with the Taxpayer on a principal to principal basis.

Before proceeding with our analysis, we note that we accept the Taxpayer's contention that Mr E, of Company F, acted as agent of the Taxpayer in negotiating with Company B (fact 16 refers). Matters to the contrary referred to by the Commissioner, namely (1) that there was no formal agency agreement between the parties and (2) the method by which Company F was remunerated (fact 18 refers), do not preclude the existence of agency. On the evidence before us, and on the facts found, we conclude that Mr E of Company F acted as the Taxpayer's agent because the Taxpayer expressly consented that Mr E should act on its behalf and, in turn, Mr E consented so to act. In the result, we did not disregard the activities performed by Mr E and, to the extent that they were relevant to earning the profit in dispute, we have taken them into account.

Having identified what activity produced the gross profit from the Company B's transaction, we now proceed to determine where this was done. On the sales side, the evidence before us is incomplete. For instance, the Taxpayer did not produce the actual purchase order from Company B, although we have found as fact that one did exist (fact 4(b) refers; see also note 1). Similarly, there is no direct evidence on where the terms of sale acceptable to the Taxpayer were discussed and agreed with Mr E. In all the circumstances, we are not able to state with certainty whether, as Mr C argued, the contract was concluded by Mr E in Country D or whether, as he said elsewhere in evidence, 'If you accept a letter of credit and act on it, [you have] an offer and acceptance. So, it seems to me that [Company B] effectively made an offer to us. We accepted it by supplying to them' (fact 17 refers).

The whole matter then is replete with ambiguity. After considering the whole of Mr C's evidence and the various documents placed before us, we can only infer that relevant activity took place both in Hong Kong and Country D regarding the negotiations and conclusion of the sales contract. In any event, we are not persuaded that all relevant activity relating to the Company B's sale took place outside Hong Kong.

On the purchase side, we accept the Commissioner's argument that the relevant activity took place wholly in Hong Kong. Specifically, all the Taxpayer's dealings with Company I concerning Company B's transaction took place in Hong Kong and the contract was concluded in Hong Kong.

Mr C argued, however, that in substance this was all referable to a relationship with a state enterprise in Country G which had been established for many years. Before dealing with this argument, we note that it is not in dispute that this Board must determine the source of profits from individual transactions. Furthermore, as indicated by the decisions in Hang Seng Bank and Magna Industrial, we must apply the broad guiding principle and examine the totality of facts to see what the Taxpayer had done to earn the relevant profits. Bearing in mind these principles, we find that Mr C's evidence related to a period long before the relevant contract was effected; indeed it related in part to a time before either the Taxpayer or Company I was incorporated. In summary, Mr C's evidence showed, in very broad outline, that various connections or relationships were established between him and relevant organizations in Country G. This does not alter the fact that, in relation to Company B's transaction, all dealings between the Taxpayer and Company I took place in Hong Kong and that the purchase contract between the Taxpayer and Company I was effected in Hong Kong. If the Taxpayer had concluded a master supply agreement with the supplier in Country G and, subsequently, individual agreements were simply accepted in Hong Kong which were referable to that master purchase agreement, the answer may well be different. But this was not the case before us.

We turn now to the processing of the order from Company B by the Taxpayer and the negotiation and opening of finance facilities by the Taxpayer. In the absence of any evidence to the contrary we infer that all this took place in Hong Kong. In this regard, we reiterate that Mr C did not give detailed evidence of overseas travel and the job requirements of the Taxpayer's employees both in and outside Hong Kong. However, it was clear from the totality of his evidence that he and the Taxpayer's employees did some work in Hong Kong to process and follow up the order received from Company B.

In the result, we are left with a very high preponderance of profit-earning activity of the Taxpayer taking place in Hong Kong. The balance might have been altered if the Taxpayer had been more forthcoming in replying to the assessor's enquiries. To be fair to Mr C he did try to cover some of these matters, albeit in response to direct questioning during the Board hearing. But the fact remains that the evidence before us on matters such as the precise nature of the overseas trips and the employment activities actually carried out by the Taxpayer's staff both in and out of Hong Kong was very thin. Mr C put the Taxpayer's case very much from the perspective of the practical businessman, endeavouring to give the Board a broad brush picture rather than detail, and trying to downplay the Taxpayer's refusal to answer questions directly put to it by the assessor. From a business perspective we understand Mr C's explanation of the Taxpayer's approach to this appeal. But, from the perspective of complying with the requirements of the IRO, it is inexcusable; it has also, as indicated above, proved counterproductive.

The remaining transactions

Turning now to the remaining transactions, the picture is even murkier. There was virtually no evidence produced to us on these transactions. Specifically, Mr C only gave a very general description of them and did not supply one single document. This was surprising given that the Commissioner had not been satisfied that Company B's transaction

was representative of all other transactions. Mr C said in evidence that Company B's transaction was representative. But again, apart from Mr C painting the broadest picture, we do not know in any one case what goods were supplied, how they were sourced, how the sales were solicited (although they can be distinguished because Mr E was not involved and no commission was paid), how the orders were processed, how the financing was arranged and how payment was effected. Indeed, we do not even know the precise number of transactions entered into, let alone the identity of the Taxpayer's customer.

In all the circumstances we find that the Taxpayer has not discharged its onus to show that the profits from these transactions arose outside Hong Kong.

Before concluding we wish to comment briefly upon the Magna Industrial case given the emphasis that Mr C placed upon it in argument. In our view, this case is clearly distinguishable from the facts of the present appeal. Specifically, unlike the Taxpayer, Magna did virtually nothing in relation to purchasing its trading stock; unlike Mr E, the authority of Magna's export agents to conclude binding contracts was well documented and the effecting of sales contracts outside Hong Kong was crystal clear; and unlike the Taxpayer, who apparently entered into only four or five major transactions during the year, Magna entered into literally hundreds of low volume low price transactions which were capable of being considered under the same rubric. Having regard to the totality of facts before us and the dictum of the Court of Appeal that the decision in Magna Industrial was on the limit of the spectrum of the so-called 'rates cases' of Hong Kong businesses having offshore profits (at 610), we have no hesitation in concluding that Magna Industrial cannot be applied on all fours to the present appeal.

Throughout this appeal the Taxpayer sought to challenge the Commissioner's assessing practices as set out in Departmental Interpretation and Practice Notes No 21 (note 2 above and accompanying text refer). It is now clear that the Practice Note is inconsistent with the decision in Magna Industrial. We therefore agree with Mr C's argument on this issue. This does not, however, alter out conclusion.

For all the above reasons the appeal is dismissed.