INLAND REVENUE BOARD OF REVIEW DECISIONS

**Case No. D57/89**

Profits tax – interest income – whether interest arose from carrying on business in Hong Kong – section 15(1)(f) of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Joseph E Hotung and Hwang King Hung.

Date of hearing: 3 August 1989.
Date of decision: 4 October 1989.

The taxpayer was a corporation carrying on business in Hong Kong as a 'garment manufactory'. The taxpayer earned significant interest on deposits with banks in Singapore, USA, and Hong Kong. It was argued by the taxpayer that the interest did not arise in and was not derived from Hong Kong. It was further argued that the interest was not earned from the taxpayer carrying on business in Hong Kong and that accordingly section 15(1)(f) of the Inland Revenue Ordinance did not apply.

Held:

All of the interest income was taxable because it arose from the taxpayer carrying on business in Hong Kong.

Appeal dismissed.

D J Gaskin for the Commissioner of Inland Revenue.
Austin A Iles of Pacific Taxation Services Ltd for the taxpayer.

Decision:

This is an appeal by a company against a profits tax assessment for the year of assessment 1985/86 in which the Taxpayer has been assessed to profits tax on interest income which the Taxpayer claims is not subject to tax under the Inland Revenue Ordinance.

At the hearing of the appeal the representative for the Taxpayer informed the Board that the Taxpayer agreed the facts as set out in the determination of the Commissioner and no witnesses were called to give evidence. Certain additional documentary evidence was tabled which mainly comprised minutes of some board meetings of the Taxpayer and

copies of some statutory records providing details of shareholders and directors of the Taxpayer.

The representative for the Commissioner also said that he was not calling any witnesses to give evidence and relied upon the facts contained in the determination of the Commissioner and certain additional documentary evidence which he also tabled.

The Board drew to the attention of the parties that the 'facts upon which the determination was arrived at as' set out in the determination contained very little by way of fact and primarily set out arguments which the representative for the Taxpayer had submitted to the assessor or the Commissioner in the course of the handling of the matter by the Inland Revenue Department. The Board pointed out that this situation was unsatisfactory for the parties and for the Board.

The facts, such as they are, are as follows:

1. The Taxpayer was incorporated in Hong Kong as a private company in June 1965 and at all material times carried on business in Hong Kong with its nature of business described as 'garment manufactory'. The relevant financial year of the Taxpayer ended on 30 November 1985.

2. The full objects contained in the memorandum of association of the Taxpayer were included in the evidence before the Board and comprised the usual wide type of objects used in Hong Kong and which allow the Taxpayer to carry on a very wide range of activities including manufacturing trading and the investment of moneys.

3. For many years prior to the year of assessment 1985/86 the Taxpayer had made profits from its garment manufacturing business which profits were retained by the Taxpayer and not paid to its shareholders by way of dividend.

4. In respect of the year of assessment 1985/86 (that is, during the Taxpayer's financial year ending 30 November 1985) the Taxpayer earned interest income of $1,591,099 made up as follows:

| | $ |
|---|---|
| A bank in Singapore – ACU deposits | 94,181 |
| A bank in USA – US$ fixed deposits | 1,482,054 |
| A bank in Hong Kong – US$ savings account | 14,864 |
| Total | $1,591,099 |

5. It was submitted on behalf of the Taxpayer and not disputed but at the same time not agreed by the Commissioner that the shareholders of the Taxpayer during the financial year ending 30 November 1985 were a corporation and an individual having addresses in New York, USA and that the directors were three individuals whose usual places of residence were also New York, USA. For the reasons given in our decision we accept that this submission is true and correct.

6. It was submitted on behalf of the Taxpayer and accepted by the Commissioner that the Taxpayer did not carry on any type of investment business either within or outside of Hong Kong.

7. In respect of the year of assessment 1985/86, section 15(1)(f) of the Inland Revenue Ordinance read as follows:

> '(f) sums received by or accrued to a corporation by way of interest arising through or from the carrying on by the corporation of its business in Hong Kong, notwithstanding that the moneys in respect of which the interest is received or accrues are made available outside Hong Kong.'

8. The assessor was of the opinion that the interest set out in fact 4 above was subject to profits tax under the then wording of section 15(1)(f) of the Inland Revenue Ordinance and the assessor duly assessed the Taxpayer to tax on this interest. The Taxpayer objected to this assessment and the Deputy Commissioner in his determination dated 28 July 1988 upheld the assessment.

9. The Taxpayer has duly appealed against the determination of the Deputy Commissioner to the Board of Review.

At the hearing of this appeal the parties argued at some length regarding the meaning of section 15(1)(f) of the Inland Revenue Ordinance as it then was. However on the facts of this case there appears to us to be no ambiguity with regard to the wording of section 15(1)(f) and it is therefore not necessary for us to analyse or comment on the submissions made before us.

This case is quite simple and falls to be determined on the facts which we have before us.

With due respect to the representative for the Taxpayer, we are not able to agree with the conclusions which he sought to draw from the submissions which he made. He submitted that the business of the Taxpayer was that of garment manufacturing. He drew our attention to the wording of section 15(1)(f) which refers to 'its business in Hong Kong'. He submitted that 'its business' was in this case the business of garment manufacturing. With this part of his submission we are in agreement. He then went on to submit that the Taxpayer did not carry on a separate business of investing money and with this second part

of his submission we also agree. The representative for the Taxpayer then argued that the interest did not arise from the Taxpayer's business, namely its garment manufacturing business, and that as the Taxpayer did not carry on a business of investing money, the interest in question did not arise through or from the carrying on of its business within the meaning of section 15(1)(f) of the Inland Revenue Ordinance. It is with this part of the representative's argument that we do not agree.

If the Taxpayer's only business was that of garment manufacturing in Hong Kong then surely the interest which the Taxpayer earned must derive from that business. The representative for the Taxpayer appeared to argue that the interest did not arise from the garment business. With due respect we cannot agree with this. Either the money arose as part of the Taxpayer's business which, on his own submission, was garment manufacturing, or on the other hand arose from a separate business of investing money which the Taxpayer's representative denied.

The representative for the Taxpayer submitted that the Taxpayer was actually owned, managed and controlled outside of Hong Kong. He submitted that the moneys from which the interest was earned were placed on deposit outside of Hong Kong by the directors who were residents outside of Hong Kong. With due respect to the Taxpayer's representative we have no evidence regarding this. He produced copies of a number of resolutions passed by the directors of the Taxpayer at meetings held in New York to support his submission. However we do not have any direct evidence from any of the directors as to how the day-to-day business of the Taxpayer was managed and controlled. We do not know whether other board meetings were held outside of New York. He said that the Taxpayer had full time staff in Hong Kong who ran only its garment business and who were under the direct control of the directors in New York. It is not for us to speculate as to how the Taxpayer may or may not have carried on its business. It is for us to find the facts and decide the case accordingly. The onus of proof is clearly placed upon the Taxpayer by the Inland Revenue Ordinance. The interest was earned from three banks, one of which is stated to have been in Hong Kong. We enquired of the Taxpayer's representative whether any distinction was to be drawn between interest on moneys placed on deposit in Hong Kong and moneys allegedly placed on deposit outside of Hong Kong. He informed us that no distinction was drawn and that none of the interest should be taxable. We cannot see how it can be that money placed on deposit with a bank in Hong Kong, albeit in US dollars, is not taxable in Hong Kong.

It was submitted on behalf of the Taxpayer that the moneys which were placed on deposit were surplus to the requirements of the Taxpayer in its garment manufacturing business. Here again we have no conclusive evidence. The Commissioner's representative disputed this submission and produced extracts from the Taxpayer's accounts or the auditor's working papers to show that during the period in question moneys were transferred to and from the general account of the Taxpayer to its deposit account and vice versa. This suggests that some of the moneys on deposit had a close relationship to the garment manufacturing business. We had no evidence that the moneys had been separated from the garment manufacturing business.

However even if the moneys were set aside, on the facts before us we still could not find in favour of the Taxpayer. On the submission before us the Taxpayer was only carrying on one business and the interest in question arose from the Taxpayer placing on deposit moneys which originated from that business and which were available at all times for the Taxpayer to use in that business. Had the Taxpayer transferred the moneys offshore and had the Taxpayer carried on a separate business of investing moneys offshore then our decision might have been different. However it is not necessary for us to speculate in this regard because the facts before us are quite clear to the contrary and we have no hesitation in dismissing this appeal. Section 15(1)(f) of the Inland Revenue Ordinance as it then was made a corporation taxable on interest earned from its business regardless of where the moneys were made available. In this case it would appear that the company made moneys available to banks, in one instance in Hong Kong, and in other instances outside of Hong Kong. Because of the then wording of the Ordinance, all of this interest is taxable if it arose from the Taxpayer carrying on its business in Hong Kong. Both parties have submitted that the only business conducted by the Taxpayer was its garment business in Hong Kong. Accordingly the interest in question must have arisen from that business. We reject the submission that the garment manufacturing business was in fact carried on outside of Hong Kong.