Case No. D7/84

Board of Review:

William Turnbull, *Chairman*; Professor P. G. Willoughby & David C. S. Wu, *Members.*

9 July 1984.

Profits tax—financial institution—section 14 of the Inland Revenue Ordinance—whether interest on offshore syndicated loans derived from Hong Kong.

The appellant was incorporated in Hong Kong and was the subsidiary of a company incorporated in Tokyo. The appellant took part in offshore syndicated loans. The Commissioner included the interest on the loans in the Profits Tax assessments for the years 1978/79 and 1979/80. The appellant appealed against the assessments on the ground that the interest on the loans was derived from a source outside Hong Kong, and relied heavily on the place where credit is provided test.

Held:
The determination of the source of interest is a matter of fact. The question to be answered in each case is what would a practical man regard as the real source of income taking into account all relevant factors of which the place where credit is provided is only one. Taking into account all of the relevant facts of this case the source of the interest from the offshore syndicated loans was derived by the appellant from Hong Kong.

Appeal dismissed and assessments remitted to the Commissioner for revision accordingly.

A. K. Gill for the Commissioner of Inland Revenue.
D. Flux of Peat Marwick, Mitchell & Co. for the appellant.

Reasons:

1. The Company was incorporated on 13th March 1973 and is a subsidiary of the head office. At all material times the Company carried on the business of finance, money lending and investment and was a financial institution within the meaning of section 2 of the Inland Revenue Ordinance ("the Ordinance"). That part of the business of the Company particularly relevant to the appeal was stated to be "the borrowing and lending of money".

2. The Company filed tax returns for the years of assessment 1978/1979 and 1979/1980 in which some of the Company's income was declared to be Hong Kong source income and accordingly taxable under the Ordinance and some was claimed to be non Hong Kong source income and not taxable under the Ordinance.

3. Following various submissions arguments and representations agreement was reached between the Company and the Commissioner relating to the taxable income of the Company save and except for interest received by the Company on its participation in offshore syndicated loans and income received by the Company in respect of the same participation in the same loans described as "participation, management and commitments fees".

4. Although described as "participation, management and commitments fees", these fees were not payments in the nature of fees for services but were additional sums received as "front-end" remuneration for participating in the loans. The Company did not act as manager, co-manager or agent in respect of any of the offshore syndicated loans in which it participated in the two years under appeal.

5. The Company was formed as a subsidiary to develop the head office's business in South East Asia at a time when a branch of the head office could not be opened in Hong Kong. The head office regarded the Company as a branch office. In June 1979 the head office opened a branch office in Hong Kong which took over some of the Company's retail banking functions, this included some loan business, local deposit taking business and bills of exchange business. After the establishment of the Hong Kong branch by head office, the Company was responsible for handling syndicated loans, single loans, local loans, and ship financing.

6. During the material period the Company had no less than 17 employees including the following Japanese officers:—

A—Manager (until 24/6/79)
B—Manager (until 24/6/79)
C—General Manager
D—Managing Director (until 24/6/79)
E—Manager (from 1/7/79)

At all material times P was Chairman of the Company's board of directors.

7. The Japanese officers of the Company were responsible to the head office for the day to day management of the Company. Their responsibilities included seeking new business, obtaining funds to service loans made in the Company's name, referring potential business to the head office for approval, and investing surplus funds. These activities were carried out under the close supervision of the head office.

8. The procedures adopted by the Company in relation to its participation in the offshore syndicated loans were explained to the Board of Review by N, a senior officer of the Company. Although not the senior officer of the Company during the years in question, N was fully conversant with the affairs of the Company during that period and had been employed by head office since 1970. The Board of Review accepted the evidence of N in

relation to the participation of the Company in the offshore syndicated loans in question. It was as follows:—

(*a*) A syndicated loan is a procedure used to enable a group of banks to make substantial loans and foreign sovereign loans.

(*b*) A syndicated loan has two parties namely the lead manager and the participants.

(*c*) The relationship between the lead manager and the participants is that the lead manager negotiates the terms of the loan and the total amount of the loan with the borrower. However, the lead manager takes no part of the risk which is taken by the participants. An information memorandum is prepared by the lead manager in each case and this clearly states that the lead manager takes no responsibility for any risk which the participants may accept.

(*d*) After the lead manager has completed negotiations with the borrower the lead manager prepares and issues two documents. The first document is an invitation telex which stipulates the terms and conditions of the loan as well as the fee the lead manager will pay to participants. The second document is the information memorandum. This is a support document which explains basic data including the financial position of the borrower.

(*e*) The participants take the risk involved in the lending. For this reason they have direct contact with the borrower. This is important so that each participant can assess the risk and ascertain the credit worthiness of the borrower. Each participant makes an independent decision as to whether or not to participate in a loan. The participant does not have nay right or power to negotiate terms with the borrower. He must accept or reject the terms and conditions as negotiated previously by the lead manager with the borrower.

(*f*) When assessing the risk the prospective participant considers not only the credit worthiness of the borrower but also the country risk which means assessing the social, economic and political risks of the country to which the money is being lent.

(*g*) The method of operation of the head office and the Company was that the head office had established a number of departments in Tokyo to collect worldwide data, control overall policy and make decisions regarding participation in syndicated loans throughout the world. The international department of head office was responsible for basic policy decisions, and the supervision and control of the profitability of overseas operations including the Company. It has responsibility for country risk analysis, both as to quality and quantity. Information was collected and provided from the research department of head office which was divided into general research, industrial research, and

international finance research. In addition head office maintained a credit appraisal department.

(*h*) The Company was not permitted to arrange any loan without the direct support, supervision, approval and control of head office.

(*i*) Based on the country risk analysis carried out by its international department, head office set up exposure limits for each country and gave specific approval for participation in individual loans. This function was carried out by the international finance coordination department of head office. Participation in every loan had to be submitted to a board meeting in Tokyo which comprised the managing director of head office together with representatives of all departments.

(*j*) Head office as a matter of fundamental policy required all loans and loan participation worldwide to be controlled through Tokyo.

(*k*) The role and work performed by the Company in relation to participation in syndicated loans was to seek business opportunities. The Company liaised with potential and actual borrowers who had their business or operations in Hong Kong.

(*l*) Upon receipt of a telex from a lead manager the Company refered the matter to head office in Tokyo. The Company then acted as a liaison office between head office and the borrower until a decision was made by head office whether or not to participate in the syndicated loan.

(*m*) In the event that head office decided to participate head office would also decide which branch or subsidiary in which part of the world would participate and to what extent.

(*n*) Having been informed of a decision that the Company was to participate the Company then relayed the decision back to the lead manager saying that the Company accepted participation in the syndicated loan subject to the necessary documentation. When the documentation was received by the Company three copies were provided. One copy was sent to head office in Tokyo, one copy was provided for the in house lawyer and the third copy was used by the booking office. When the documents had been approved and accepted the same were executed usually in the home country of the borrower.

(*o*) When the Company required funds, it contacted its chief dealer to obtain the necessary funds from the market on behalf of the Company and in the name of the Company. This function was performed entirely in Hong Kong and the Company had complete power and responsibility over the funding function. The dealer might find money from anywhere in the world but having done so this was recorded in the books of the Company in Hong Kong. When participating in

syndicated loans the Company would pay its participation to an account opened by the lead manager for this purpose and the lead manager would pay the moneys to the borrower's bank account.

(*p*) The policy of the Company in relation to syndicated loans was to lend long but borrow short with the period of borrowing normally being equal to the interest periods under the syndicated loans. These were ordinarily three or six months. As the Company had many loans and participated in many syndicated loans it did not always match borrowings with loans but might take a position in the market for short periods of time. The funding of the loans was described as a "pool concept" whereby the loans were pooled and financed collectively and not individually.

(*q*) As each short term borrowing by the Company fell due it was repaid and re-financed. The borrower had long term funds made available to it and did not repay the Company other than in accordance with the terms of the loan documentation.

(*r*) Although the Company obtained its funds from many sources in the world including Hong Kong, Singapore, and London all of the loans in question in the two relevant years of assessment were designated in United States Dollars and all receipts and payments relating thereto were cleared in New York which was the only clearing house in the world for such funds. This meant that when lending money the Company would provide United States Dollars in New York and when borrowing and repaying money it would likewise borrow and repay through bank accounts in New York.

(*s*) The procedure adopted by the Company when making single loans to individual borrowers and when participating in syndicated loans was identical in every case.

9. The Company did not maintain any offices, branches, or staff outside of Hong Kong. All records and accounts of the Company were maintained in Hong Kong.

10. Subject to the foregoing amplifications and explanations, the statement of facts contained in the Commissioner's determination was confirmed to be true and correct by the representative of the Company.

Case cited before the Board

C.I.R. v. Lever Brothers & Unilever Ltd. (1946) 14 S.A.T.C. 1
C.I.R. v N.V. Philips Gloeilampenfabrieken (1954) 10 A.T.D. 435
C.G. of I.T. v Esso Standard Eastern Incorporated (1969) Court of Appeal for East Africa (Unreported)
Nathan v. F.C. of Taxes (1918) 25 C.L.R. 183
Rhodesia Metals Ltd. (in liq.) v. C.T. [1940] A.C. 774; [1940] 3 All E.R. 422
C.I.R. v. Hong Kong & Whampoa Dock Company Ltd. (1960) 85 H.K.T.C.

C. of T. (New South Wales) v. Hillsdon Watts Ltd. (1936) 57 C.L.R. 36

This appeal is by the Company against assessments made on it by the Commissioner for the years 1978/79 and 1979/80. Agreement has been reached between the Company and the Commissioner as to the amount of the taxable income of the Company with the exception of 3 items namely (*a*) income described as "interest on offshore syndicated loans", (*b*) income described as "participation, management and commitments fees" and (*c*) the calculation of the proportion of the Company's expenses which should be allocated to that part of the Company's income which is taxable in Hong Kong.

In the course of the hearing it was agreed that the apportionment of expenses could not be determined until after the liability to tax on the interest and on the fees had been determined. Accordingly the Board of Review was not asked to adjudicate on this and the Company reserved the right to refer this back to the Board of Review in the unlikely event that the Company and the Commissioner were unable in due course to agree on the apportionment of expenses.

With regard to the fees it was accepted by the Company and the Commissioner that the fees were an additional payment received by the Company by way of a front end fee for participating in the offshore syndicated loans. It was agreed that if it were decided that the interest was not taxable then these fees would not be taxable; if the interest were taxable under section 14 of the Ordinance then these fees would likewise be taxable; but they would not come within section 15(1)(*i*) as they were not interest. On this basis the Company's tax liability on these fees were not separately argued. The Board of Review accepted this method of proceeding because the evidence made it clear that these fees were not for any additional or extra services performed by the Company other than its participating in the loans. If, however, the Company had taken part in the negotiations or management of the syndicated loans then it may well have been that the decision of this Board would have been different on this question of procedure. The clearest evidence was given to the Board on behalf of the Company that in relation to these syndicated loans the Company was no more than a participating lender and was not involved in any way in the negotiations with the borrower leading to the proposal for participation in the syndicated loan nor in the subsequent management of the syndicated loan.

It having been so agreed by the Company and the Commissioner the appeal proceeded purely on the question of whether or not the interest on the offshore syndicated loans was subject to tax in Hong Kong.

The Board is indebted to both Mr. Flux who appeared for the Company and Mr. Gill who appeared for the Commissioner who argued the law and explained the facts with great thoroughness and clarity. The Board also received considerable assistance from the one witness who was called to give evidence.

Two sections of the Ordinance must be considered. Firstly, it is necessary to decide whether the interest is income which is taxable under section 14. If the answer is in the negative only then it is necessary to look at the provisions of section 15(1)(*i*).

The relevant words of section 14 are:—

> "Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in the Colony in respect of his assessable profits arising in or derived from the Colony for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part."

The question before the Board is to decide whether the interest from the offshore syndicated loans was derived from Hong Kong and therefore had a Hong Kong source.

Mr. Flux submitted that the test for source of interest was the place where the funds were made available to the borrower. He said that as all of the loans were United States Dollars paid and cleared through bank accounts in New York, the interest was not assessable in Hong Kong. He cited three cases as authority for this proposition, namely:—

C.I.R. v. Lever Brothers & Unilever Ltd. (1946) 14 S.A.T.C. 1
C.I.R. v. N.V. Philips Gloeilampenfabrieken (1954) 10 A.T.D. 435
C.G. of I.T. v. Esso Standard Eastern Incorporated (1969) Court of Appeal for East Africa (Unreported).

He said that these cases had, as a matter of practice, been accepted in Hong Kong and that the Inland Revenue Department had issued a practice note stating that the source of interest was almost invariably the place where the funds were made available.

It is convenient here to repeat in summary the mechanics and basis of operation of the Company in relation to offshore syndicated loans. The Company actively sought and solicited loan business. Telex offers to participate in offshore syndicated loans were received by the Company from the lead manager together with the relevant information memorandum. In every case this was referred to head office in Tokyo. The Company was a subsidiary of head office. The offer to participate would be evaluated by head office and a decision taken whether to and how to participate. The Company performed liaison services with the borrower during the evaluation period and could make recommendations but had no authority to make any decision. If head office decided to participate in the syndicated loan, it would also decide which of its branches or subsidiaries would be used for the participation. Depending on what head office decided the Company might or might not participate in loans referred through it.

When participation by the Company had been approved or directed, the Company would then indicate acceptance to the lead manager subject to satisfactory documentation. Upon receipt of the documentation a copy would be sent to head office.

If the documentation was acceptable it would be executed by the Company usually in the country where the borrower was situated.

Payment of the Company's participation would be made by the Company in United States Dollars to an account opened by the lead manager in New York. On the due date the lead manager would transfer the moneys provided by the Company together with the moneys provided by other participants in United States Dollars to a bank account also in New York opened by the borrower. Interest payments and capital repayments would be made by the borrower to the various participants through the lead manager in a similar manner through New York.

To fund its lending requirements the Company used the services of a money dealer in Hong Kong who would obtain the necessary funds anywhere in the world as was convenient but cleared through New York because the funds were in United States Dollars. All funding decisions were made and controlled in Hong Kong, the policy being to lend long and borrow short. Funding requirements were pooled for many different loan participations without allocating any particular borrowing to any particular loan.

All records and accounts of the Company were maintained in Hong Kong.

The facts of this appeal are very different from the three cases cited by Mr. Flux.

The **Lever Brothers** case did not involve a commercial bank lending. A holding company carrying on business in England sold certain assets to a Dutch company leaving a sum of money owing from the Dutch company to the holding company on which interest was to be paid. Security for the indebtedness comprised shares in an American company carrying on business in the United States. The Dutch company then transferred to a South African company its obligations to the holding company and also its interest in the shares which had been given as security for the indebtedness. Interest was paid by the South African company to the holding company on the indebtedness making use of dividends due on the shares which were then held as security. The South African Government expressly prohibited the South African company from making use of assets or moneys in South Africa for paying the principal or interest.

The South African Commissioner attempted to claim tax on the interest payments as being South African source income. On appeal the South African Supreme Court in its Appellate Division decided that the interest was not taxable as it was not South African source income.

The Commissioner submitted that the debt was situated in South Africa because the debtor was resident in South Africa and therefore the interest was South African source income. Watermeyer, C. J. rejected this argument as being artificial. He cited the well known test formulated by Isaacs, J. in **Nathan v. F.C. of Taxes** (1918, 25 C.L.R. 183). "Source means not a legal concept but something which the practical man would regard as a

real source of income. The ascertaining of the actual source is a practical hard matter of fact." This test was approved by Lord Atkin in the Privy Council in **Rhodesia Metals Ltd. (in Liq.) v. C.T.** [1940] A.C. 774; [1940] 3 All E.R. 422.

Watermeyer C. J. said p. 14:—

> "No business was carried on by Levers in South Africa, no contract was made by them in South Africa, no capital was adventured by them in South Africa, no services were rendered by them in South African and no obligation resting on either party was performed or was to be performed in South Africa. In fact there were no activities of any sort by Levers in South Africa except possibly those connected with the flotation of Overseas Holdings in South Africa. Consequently, according to the meaning which, in my opinion, has been given to the word 'source' by the decision of the Privy Council and of this Court, the source of the income which the Commissioner wishes to tax was not located in South Africa."

Finally Watermeyer C. J. says at pp. 15/16:—

> "Again, if Lord Atkin's suggestion be followed and the question be asked what would the practical man regard as the real source of the income, although I have some difficulty in differentiating the reasoning of the practical man from that of the theoretical lawyer for this purpose I think the answer would probably be that the source of Levers' income was the operations of the American company which produced the money out of which the interest was paid. I cannot think that the practical man could have ever come to the conclusion that the money came from a source in South Africa."

In a supporting Judgement, Davis, A. J. A. said at p. 23:—

> "I agree that the appeal should be dismissed. Adopting, as I think I am bound to adopt, the test approved by the Privy Council in the **Rhodesia Metals'** case (1940, A.D. 432) I have little doubt that the practical man would say that the source of Levers' income was the provision by it of assets in America and the giving of credit in England. He might have difficulty in deciding whether the source was located in England, where, *inter alia*, the contracts were made, where the trustee was situated, where the credit was given and where all payments had to be made; or whether it was in America where the assets were situated, and where those assets earned that money out of which the interest was paid. But the one place he could not choose would be South Africa. I cannot conceive of the practical man saying that, although the Treasury had only agreed to the transaction going through at all on the express condition that not one penny piece of capital or interest should be paid from any funds in South Africa, and although that condition had been fully carried out and not one penny piece had come from South Africa, yet the Treasury was right in now claiming that the whole of the interest had come from a source in South Africa, although the Treasury and the practical man both knew that as 'a practical hard matter of fact' none of it had done so, and that indeed, the debtor possessed no assets in South Africa from which it possibly could have come. For the person whom Lord Atkin had in mind was the practical man and not the legal theorist who, by resolutely shutting his eyes to all the facts, could prove that black was white."

The **Lever Brothers** case is no authority for the contention that the place of provision of funds almost invariably governs source of interest. **C.I.R. v. N.V. Philips Gloeilampenfabrieken** is likewise no authority for the so-called provision of credit test. Its facts are also quite different from those of the present case. It is a New Zealand decision involving a New Zealand company which imported goods from a Dutch company on terms that it should pay for the goods in sterling in Holland. The New Zealand company was unable to pay for the goods which it had purchased and the Dutch company therefore made a loan of L80,000 to the New Zealand company repayable by instalments together with interest, all payments to be made in sterling in Holland. The Dutch company provided the loan by sending to the New Zealand company a cheque for L80,000 drawn on a London bank and made payable to the order of the New Zealand company. The New Zealand company endorsed the cheque payable to the Dutch company and returned it in payment of its outstanding debts for the goods supplied. The New Zealand Commissioner claimed tax on the interest which arose as being either interest on moneys lent in New Zealand or interest which directly or indirectly was derived from New Zealand.

Three main judgements were delivered, all of which decided that the interest was not on moneys lent in New Zealand nor was it directly or indirectly derived from a New Zealand source. Beyond that there appears to be no accord and much confusion. Gresson J. held that the money was provided or must be deemed to have been provided or lent in London because a sterling London cheque was used. In relation to "source" he said at p. 164:—

> "In my view, therefore, the originating cause being that Philips-Holland had lent moneys or provided a credit in London, from which sprang the obligation to pay interest, the 'source' of Philips-Holland income was not in New Zealand, even though the borrower resorted to its New Zealand funds to pay the interest."

North, J. was of a different opinion. Having approved the test laid down in Nathan's case that source or derivation of income is a "practical, hard matter of fact", he says at p. 168:—

> "Now, it is plain that the respondent did not perform any services in New Zealand, for it is an overseas company engaged in business in the Netherlands, and not in New Zealand. Arising from its business transactions in that country, it found it necessary in the ordinary course of business and not with the object of making an investment to make a loan to one of its customers. The question then is whether the interest on this loan has its source in the quarter from which the income was received or in the contract which I have earlier found was made in the Netherlands. Counsel for the Commissioner submitted that the source of the income was the interest-bearing debt and that, as the debt is payable by a New Zealand company, the source of the income was New Zealand, even although the interest was to be paid and the principal repaid in the Netherlands. A similar argument was submitted to the Court of Appeal in South Africa in **Commissioner for Inland Revenue v. Lever Brothers and Unilever Ltd.,** but it found no favour with the majority of the Court."

He goes on to say at p. 179:—

> "In my opinion, applying the practical hard matter of fact test, no one can really doubt that the actual source of this income was the credit made available by way of loan under the agreement made in the Netherlands in the course of the respondent's business in that country. I do not think it can be said that the respondent owned 'property' in New Zealand. What it owned was a debt due under a contract made in the Netherlands and to be performed in that country."

North, J. concludes with the following statement at p. 171:—

> "In my opinion, then, the source of the income was the business transaction carried out in the Netherlands."

Turner, J. approached the problem from yet another point of view and he concluded his decision at p. 178 with the following words:—

> "In my view, then, the transaction, by virtue of which the interest is payable, is the source of these payments and, in my opinion, this transaction, for the reasons set out in the first part of this judgement, did not take place in New Zealand."

A close study of the **Philips** case does not support the contention that the source of interest is the place where the credit is made available. There were two questions to be decided in the **Philips'** case. The first was to decide whether or not the interest derived from "money lent in New Zealand". The Judges decided that the moneys were not lent in New Zealand. The second was to decide whether New Zealand was the direct or indirect "source" of the interest and it was held that it was not. The **Philips'** case is not a decision as to where the source of interest was but where the source of interest was not. The Court appears to have considered whether the interest could have been derived from New Zealand, Holland, or London and to have decided that it was not New Zealand. The transaction took place in Holland but the funds were made available through a cheque drawn on a London account in sterling. It is far from clear as to whether or not the court would have decided that the interest was derived from a London source or from a Dutch source.

The third case cited by Mr. Flux is an unreported decision of the Court of Appeal for East Africa, **C.G. of I.T. v. Esso Standard Eastern Incorporated.** A photocopy of this decision was provided to the Board of Review but as it is unreported the Board of Review preferred to treat it as part of the argument placed before the Board by Mr. Flux. The principal judgement in the case, given by Duffus, P. and the essence of his decision appears in the penultimate paragraph where he says:—

> "After some consideration I have come to the conclusion that the learned judge's decision must be the correct one. As he points out, the entire loan transaction was carried out in the U.S.A., a country in which the respondent company was situated and carried on business. The borrower was a company resident and doing business in Kenya and therefore the debt was one enforceable in Kenya but from the point of view of the taxpayer—the respondent company—the money was money which it had in the U.S.A.

> and which it loaned and handed over to the borrower in that country with the specific requirement that the repayment of the loan and the payment of interest was to be made in that country. The respondent company had no control over how or where the refinery company spent the loan in so far as it was concerned the loan need never have come to Kenya. The respondent company did not invest this money in Kenya, and the mere fact that it loaned this money to a Kenya company and that this was eventually brought to Kenya would not, in my view, make it liable to pay Kenya income tax on any interest which was paid under the loan agreement."

As in the other two cases cited by Mr. Flux this is also a decision of what was not the source of interest. It does not state that the place where funds are made available is the source of the interest.

In all of the three case cited to us by Mr. Flux there was a preponderance of facts pointing away from the country which the Commissioner argued was the source of interest. In each case the judgements set out a list of factors which demonstrated that the source was not in the country in question. None of the three cases are really applicable to the present facts and none of them states that the test of source is the place where the funds are made available.

The starting point in this appeal in our opinion is the statement by Isaacs J. in **Nathan v. F.C.T.** (1918) 25 C.L.R. 183 at p. 189 where he says:—

> "The legislature in using the word 'source' meant, not a legal concept, but something which a practical man would regard as a real source of income. Legal concepts must, of course, enter into the question when we have to consider to whom a given source belongs. But the ascertainment of the actual source of a given income is a practical, hard matter of fact."

This principle has been accepted frequently in many cases in Hong Kong and elsewhere. It has been cited with approval by Lord Atkin in the Privy Council in **Rhodesia Metals Limited v. C. of T.** [1940] A.C. 774 at pp. 789–790 and [1940] 3 All E.R. 422 at p. 426 and by the Supreme Court of Hong Kong in **C.I.R. v. Hong Kong & Whampoa Dock Company Limited** (1960) H.K.T.C. 85 at pp. 105 and 107.

Whenever questions of source are disputed a number of factors must usually be considered. Source should not normally be determined by reference to one factor alone. All relevant and pertinent facts should be taken into account. There is no rule as to which is the dominant factor because this will vary in different circumstances and from case to case. The question to be answered in each case is what would a practical man regard as the real source of income taking into account all relevant factors. The determination of the source of interest is no different from the determination of the source of other income. The so called "provision of credit test" appears nowhere in our Inland Revenue Ordinance nor has it been adopted in any of the decided cases. Indeed we note that in B.R. 20/75 I.R.B.R.D. 184 the Board of Review declined to apply this so called test in relation to interest due on a bill of exchange drawn on an overseas buyer and accepted outside Hong Kong. It may well be that

in some cases the place where the credit is provided is a dominant factor but this will depend upon a consideration of all relevant facts and there may well be other factors of equal or greater importance. In all three cases cited by Mr. Flux, there is one common theme. The question to be asked is what would a practical man and not the legal theorist with his eyes shut to all the facts regard as the real source of income and that is the approach which we take in this appeal.

Mr. Gill for the Commissioner drew a distinction between the "passive receipt" of interest where a person lends his own money as an investor and is not carrying on the business of lending money and situations such as the present where the Company is actively lending and borrowing money from a whole series of operations and transactions. We agree with this distinction. There is a great difference between the highly sophiscated business carried on by the Company making use of modern technology and communication systems and the facts in the three cases cited by Mr. Flux. A practical man would not simply look at where the funds for technical reasons were provided but would look at the realities of the Company's business and how it conducted its business. The provision of credit test is only one factor to be considered in the application of the "hard practical matter of fact test". While in some cases the provision of credit test may point to the source of interest, that is not the position in the present case. The source of interest derived by a modern financial institution is such that it cannot be conclusively decided by applying such a narrow, restrictive and artificial test.

The principles for determining source can be found in the **Hong Kong Whampoa Dock Company** case. The same principles apply to the present case although the Company's operations in the world of international banking are far removed from the comparatively simple salvage and towing operations which were the subject matter of the **Dock Company** case. Nevertheless in the final analysis these banking operations must be closely examined to determine the real source of the interest in the same way as it was necessary to analyse the operations of the taxpayer in the **Dock Company** case.

On the facts before us we find that the provision of credit test is not the dominant and only factor. We were told that the Company did not have its own funds available in New York or indeed anywhere in the world. Its business was run on the basis that it first found a borrower and then sought lenders to provide the funds. The source of funds for the Company was predominantly Singapore and London although occasionally it was Hong Kong and elsewhere. New York was no more than the clearing house used for technical reasons because America is the home of the U.S. Dollar and New York is the city where international U.S. Dollar transactions are cleared.

The facts of this case point to one of two possible sources of interest, namely Hong Kong or Tokyo. The parent company in Tokyo was described as the head office with the Company as a branch. For practical purposes we take no exception to this although the Company was a separate legal entity incorporated in Hong Kong having no existence outside of Hong Kong. We find nothing unusual in the fact that the parent exercised close control over its subsidiary and required all business to be referred to the parent for a decision. The fact that

credit risk analysis, county risk analysis and many other services were provided by the parent in Tokyo are likewise not unusual. It is clearly convenient to centralise policy and decision making and information and data collecting in the head office where there can be an overview of the entire world. But the Company did not run its business from or through Tokyo. It was a very active company in Hong Kong with a large staff. It actively solicited business and its officers were described in the course of the hearing as "salesmen". Through the period of assessing the credit and country risk and deciding whether to participate in the loan the Company acted as a liaison office. It was not a dormant operation. When the decision had been taken to accept participation in a loan it was the Hong Kong Company which obtained and handled the documentation. The documentation was referred to and approved by head office but it was the Company itself which was a party to the syndicated loan. When moneys were required under a syndicated loan the Company for its own account and without interference by head office funded the loan and provided the funds for the borrower. Throughout the period of the loan the Company and not head office refinanced on a short term basis its long term loan commitments, collected interest and collected repayment of principal working through the lead manager. There was no evidence given that the Company or indeed the head office had available their own capital funds to finance the loans. The evidence was that in all cases the Company went into the international finance markets to obtain the funds. The ultimate profit of the Company would have been the difference between its cost of funds and the interest and commissions which it received on the loans it made.

No evidence was given with regard to the particulars of each individual syndicated loan. The **Lever Brothers'** and the **Philips'** cases are clear authority that the business of the borrower, the residence of the borrower, and the application and use of the funds are not relevant factors. It is the lender and the business of the lender which is being assessed to tax and not the borrower or the business of the borrower. Accordingly details of the individual syndicated loans would not appear to be material. In some cases the place where the loan documentation is executed or the details of the loan documentation could be material but in our opinion not in the present case. We are not dealing with an isolated instance of a single lending but with a business carried on by the Company comprising numerous participations in numerous syndicated loans.

Taking into account all of the facts we find that there is a clear and heavy preponderance of factors in favour of Hong Kong as the source of the interest income of the Company and not Tokyo. As stated above we have already decided that the source of interest must lie in one of these two jurisdiction and have already ruled out New York as the source. In view of the preponderance of factors in favour of Hong Kong we find that the source of this interest from the syndicated loans was derived by the Company from Hong Kong.

On the authorities cited to us (**C. of T. (New South Wales) v. Hillsdon Watts Limited** (1936) 57 C.L.R. 36; and **C.I.R. v. Hong Kong & Whampoa Company Limited**) (1960) 85 H.K.T.C. we have no power to apportion the interest income partly to one jurisdiction and partly to another unless this is clearly laid down in the Ordinance. Furthermore no distinction was drawn between the various syndicated loans by Mr. Flux for the taxpayer.

On the evidence before us all the syndicated loans are to be treated together and there is no suggestion that any distinction should be drawn, one from another. Accordingly we find that the source of all of the interest from the Company's participation in the offshore syndicated loans is Hong Kong and is assessable to tax under section 14 of the Ordinance.

Having so decided it is not necessary for us to consider section 15(1)(*i*) of the Ordinance. Section 15(1)(*i*) commences with the words "sums, not otherwise chargeable to tax under this part". This makes it clear that section 15(1)(*i*) can have no application in the present case. As considerable argument was laid before us in relation to section 15(1)(*i*) and its meaning and as the interpretation of section 15(1)(*i*) has an indirect bearing on the decision which we have reached in this case it is worth making a few comments. Mr. Flux argued that the meaning of section 15(1)(*i*) was ambiguous and that one should look behind the written law to ascertain its interpretation and meaning. Perhaps the problem which faced Mr. Flux was the initial incorrect premise that the source of funds test governed the geographic derivation of interest. The meaning of section 15(1)(*i*) seems quite clear when the test for source of interest is a practical hard matter of fact. What section 15(1)(*i*) says is that if the place where the funds are made available is a factor in determining source under section 14 and if under section 14 it is decided that the interest is not subject to Hong Kong tax then the matter must be viewed again under section 15(1)(*i*) but this time the place where the funds were provided is to be disregarded as a factor in determining the source of the interest. If the only test for source of interest were to be the place where the funds were made available then by deleting this one and only source it could be argued that the interest would then have no source. However, this is an unlikely situation, the meaning of section 15(1)(*i*) would appear to be quite clear when the practical hard matter of fact test is applied and all factors, except the place where the credit was provided, are taken into account.

Finally we feel it appropriate to comment on the determination by the Commissioner of the taxpayer's objection in which he has drawn a distinction between the Company's participation in offshore syndicated loans and its making of single loans. The Commissioner has decided on the facts before him that interest on "single offshore loans" is not taxable but that interest on "offshore syndicated loans" is taxable. The evidence before the Board was that no distinction could be drawn between these two types of loans. The Company was not appealing against this part of the determination of the Commissioner which was in its favour and the representative of the Commissioner did not ask the Board to reverse the Commissioner's determination on this part of the assessment. Accordingly we make no ruling on this.

For the reasons set out above we decide that the interest received by the Company on its participation in the offshore syndicated loans is assessable to tax under section 14 of the Ordinance in its entirety and is not subject to any apportionment. We further decide that the "participation, management and commitments fees" are likewise assessable to tax under section 14 in their entirety and not subject to apportionment. With regard to the expenses incurred by the Company in relation to this income the matter is referred back to the Commissioner to ascertain the appropriate amount of the total expenses of the Company which should be attributed to this taxable income. As the two assessments must in any event

be referred back to the Commissioner and as the overall assessments involve many other items of income and are very complex it is appropriate that these two assessments should be remitted to the Commissioner to be revised in accordance with this decision and this Board directs that, in the event that the Commissioner is unable to reach agreement with the Company in relation to the amount to be allowed for the Company's expenses, the matter is to be referred back to this Board to decide.