INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D8/00

Profits tax – principal place of business in Hong Kong – certain business operations outside Hong Kong – source of profits – whether liable to profits tax – section 14 of the Inland Revenue Ordinance (' IRO').

Panel: Benjamin Yu SC (chairman), Kenneth Graeme Morrison and Anthony So Chun Kung.

Dates of hearing: 4 and 5 January 2000.
Date of decision: 10 May 2000.

The taxpayer was incorporated as a private company in Hong Kong and commenced to carry on business as a stockbroker in Hong Kong. This appeal raised the question of source of profits namely, whether the taxpayer' s profits were neither arisen in nor were derived from Hong Kong and should therefore be wholly exempt from profits tax imposed by Part IV of the IRO.

Held :

1. According to CIR v Hang Seng Bank Limited [1991] 1 AC 306, 318, three conditions must be satisfied before a charge to tax can arise under section 14 of the IRO :

   (a) The taxpayer must carry on a trade, profession or business in Hong Kong.

   (b) The profits to be charged must be from such trade profession or business, that is, the trade, profession or business carried on by the taxpayer in Hong Kong.

   (c) The profits must be ' profits arising in or derived from' Hong Kong.

2. One looks to see what the taxpayer has done to earn the profits in question and where he had done it: HK-TVBI v Commissioner of Inland Revenue [1992] HKTC 468 at 477 per Lord Jauncey.

3. It is important to focus on what the taxpayer – and not what other person or entity – has done: Commissioner of Inland Revenue v Wardley Investment Services (Hong Kong) Ltd (1992) 3 HKTC 703 at 729 per Fuad JA.

4. In appropriate cases, it may be necessary to apportion the profits by reference to their source, and only that part of the profits which arise in or are derived from Hong Kong should be subject to profits tax.

5. What directly brought in the commission was the execution of an order placed by a client. But this would in turn have been the result of: -

   (a) building up and maintaining a relationship with the client;

   (b) providing quality research and offering advice to the client on the market generally and any stock in particular;

   (c) providing an efficient and reliable service, not only in the execution of the orders, but generally in managing the client' s account, and

   (d) projecting and maintaining an image of repute and reliability.

6. In seeking to answer the question posed by Atkin LJ in F L Smith v Greenwood [1921] 3 KB 583 at 593, namely: ' where do the operations take place from which the profits in substance arise?' or the question formulated by Lord Jauncey in HK-TVBI v Commissioner of Inland Revenue [1992] HKTC 468 of what the taxpayer has done to earn the profits in question and where did he do it, the Board did not think it right to limit the inquiry only to the execution of the order. On the contrary, the matters set out in the above paragraph (5) should be taken into account.

7. The Board of Review considered it right to draw the inference that the taxpayer engaged the overseas offices as its agents to perform the task of liaising with clients including soliciting and handling of clients' order.

8. In all the circumstances, and on the evidence, the Board of Review came to the conclusion that the source of the commission generated from overseas clients was substantially offshore despite some of the taxpayer' s activities in Hong Kong would have contributed to the making of those profits.

9. Having regard to the other matters which the Taxpayer did through its agents, which were clearly outside Hong Kong, such as the maintenance of the relationship with the client, the processing, handling and management of the orders and the provision of the primary research materials, the Board considered that the profits generated from orders from overseas clients arose substantially from an offshore source.

10. The profits earned from the execution of orders from Hong Kong clients on overseas market can truly be said to be derived from operations carried out both within and

outside Hong Kong. In these circumstances, the Board of Review needed to consider whether apportionment of the profits was possible.

11. The Court of Appeal had held that apportionment was not possible: CIR v Hang Seng Bank Ltd [1989] 2 HKLR 236.

12. The Board of Review was bound by the said Court of Appeal decision and could not make any apportionment.

13. Instead, the Board of Review had to determine one single source which was the predominant source of the profits or the locality where the acts more immediately responsible for the receipt of the profit were conducted: Commissioner of Taxation v Hillsdon Watts Ltd (1936) 57 CLR 36 at 52.

14. In respect of commission generated from orders given by Hong Kong clients, the Board of Review were of the opinion that the predominant source, as well as the source where the acts more immediately responsible for the receipt of the profits, was Hong Kong.

15. The transactions which gave rise to the corporate finance income would have been the agreement it had with its affiliated company, Company N as well as its activities in placing the eighty-nine securities with its clients. The Board of Review had not been shown any evidence that either of these matters took place out of Hong Kong.

16. It was for the taxpayer to satisfy the Board of Review that the interest income was derived from a source outside Hong Kong and it had failed to do so. The Board of Review had no evidence as to what the taxpayer did to enable it to earn the interest income.

17. Section 68(4) of IRO provides that the onus of showing that the assessment appealed against is excessive or incorrect shall be on the taxpayer. In a case where the taxpayer satisfies the Board of Review that the reasoning of the Commissioner' s determination was wrong, and the Board of Review concludes that the assessment appealed against must be wrong or excessive, the Board of Review' s duty would be to allow the appeal; and this is so even though the taxpayer may not have adduced sufficient evidence to show what the correct assessment should be. That is why the IRO expressly confers power on the Board of Review to remit the case to the Commissioner and requires the Commissioner then to revise the assessment as the opinion of the Board of Review may require.

Appeal allowed in part.

Cases referred to:

CIR v Hang Seng Bank Ltd [1991] 1 AC 306
HK-TVBI v CIR [1992] HKTC 468
CIR v Wardley Investment Services (Hong Kong) Ltd (1992) 3 HKTC 703
CIR v Euro Tech (Far East) Limited (1995) 4 HKTC 30
IRC v Hong Kong & Whampoa Dock Company Ltd (1960) 1 HKTC 85
Magna Industrial Co Ltd v CIR [1996] 4 HKC 55
F L Smith v Greenwood [1921] 3 KB 583
CIR v International Wood Products Ltd (1971) 1 HKTC 551
Yates v GCA International Ltd [1991] STC 157
D64/91, IRBRD, vol 6, 484
Commissioner of Taxation v Hillsdon Watts Ltd (1936) 57 CLR 36

Warren Chan instructed by Department of Justice for the Commissioner of Inland Revenue.
Neil Thomson instructed by KPMG for the Taxpayer.

Decision:

The appeal

1. The Taxpayer appeals from the determination of the Commissioner of Inland Revenue dated 2 July 1999 (' the Determination'). In that Determination, the Commissioner

(a) reduced the additional assessable profits for the year of assessment 1992/93 from $74,859,693 to $31,240,889 with additional tax payable thereon of $5,467,156,

(b) reduced the additional assessable profits for the year of assessment 1993/94 from $119,806,781 to $82,173,319 with additional tax payable thereon of $14,380,331, and

(c) reduced the additional assessable profits for the year of assessment 1994/95 from $135,622,599 to $104,970,734 with additional tax payable thereon of $17,320,171.

2. By notices of appeal dated 30 July 1999, the Taxpayer challenged the Determination contending that the reduced additional assessable profits for each of the said three years of assessment, that is, 1992/93, 1993/94 and 1994/95 (' the Relevant Years of Assessment') were

profits which neither arose in nor were derived from Hong Kong and, as such, are outside the scope of the charge to profits tax imposed by Part IV of the Inland Revenue Ordinance (' the IRO').

3. This appeal therefore raises the question of source of profits.

The facts

4. The primary facts are not controversial. From the facts which the parties have agreed, we find the following facts proved:

(1) The Taxpayer was incorporated as a private company in Hong Kong on 7 October 1986 and commenced to carry on business as a stockbroker in Hong Kong on 1 May 1987.

(2) The Taxpayer is and was at the material time a member of an international stockbroking group. During the Relevant Years of Assessment, the group maintained subsidiaries and offices at various places including New York, London, Singapore, Indonesia, Taiwan, Thailand and Japan. The companies or entities which have featured in this appeal are:

Company A
Company B
Company C
Company D
Company E
Company F
Company G (which later changed its name to Company G2)
Company H
Company I
Company J
Company K

(3) The ultimate holding company of the Taxpayer was Company L incorporated in Country M.

(4) The Taxpayer' s office in Hong Kong served as the centre or headquarters of the group for the Asia Pacific region.

(5) At the material time, the Taxpayer' s offices in Hong Kong occupied five floors (although not the entire five floors) of a commercial building. Substantial

amounts for rent and rates were incurred by the Taxpayer in each of the Relevant Years of Assessment:

	$
1992	8,683,308
1993	10,638,000
1994	15,905,449

(6) It also incurred substantial expenses for salaries and allowances during each of the Relevant Years of Assessment;

	$
1992	102,285,875
1993	256,045,206
1994	225,605,617

By the end of 1995, there were over 200 staff working in the Hong Kong office.

(7) The Taxpayer derived income from brokerage commission both in respect of the Hong Kong market and overseas markets. Overseas markets would appear to cover stock markets in Thailand, Singapore, Indonesia, India, Korea and Taiwan. Brokerage commission generated from the Hong Kong market had always been offered for assessment. For the years of assessment 1987/88 to 1991/92, the assessor accepted the Taxpayer' s claim that its profits or loss from its brokerage business in respect of overseas market was offshore.

(8) In respect of the Relevant Years of Assessment, the Taxpayer' s profits and loss accounts showed, inter alia, the following particulars:

	1992/93 $	**1993/94** $	**1994/95** $
Commission and brokerage	294,839,108	518,406,677	566,376,925
Interest received	11,436,545	29,384,021	82,948,686
Management fees received	134,105,542	132,279,839	61,795,696
Other income	1,009,838	2,776,223	26,407,307
(Sub-total)	441,391,033	682,846,760	837,528,614
Less: Total expenses	364,974,130	546,014,905	710,213,113
Profit before tax	76,416,903	136,831,855	127,315,501

(9) In its proposed tax computations, the Taxpayer classified its commission and brokerage under the headings of ' Hong Kong market' and ' Overseas markets' with amounts as follows:

	1992/93 $	1993/94 $	1994/95 $
Hong Kong market	51,523,987	46,797,863	40,683,477
Overseas markets	243,315,121	471,608,814	525,693,448
Total	294,839,108	518,406,677	566,376,925

(10) Commission and brokerage classified under ' Overseas markets' were claimed to have arisen in or derived from a source outside Hong Kong and were not offered by the Taxpayer for assessment. After adjusting for various attributable expenses, the profits claimed by the Taxpayer to be offshore and excluded from its returns were as follows:

Year of assessment	Offshore gross profit $	Profit per return $
1992/93	72,390,615	38,142,737
1993/94	114,360,453	41,695,360
1994/95	102,755,459	31,057,967

(11) In 1993, the assessor commenced a review of the Taxpayer' s offshore claim. Pending the outcome of the review, the assessor issued to the Taxpayer profits tax assessments for the years of assessment 1992/93 and 1993/94 in accordance with the Taxpayer' s returns for these two years.

(12) On 18 September 1995, the assessor issued to the Taxpayer the following additional assessments:

Year of assessment 1992/93 (additional)

	$	$
Profits per computation		38,142,737
Add: Offshore brokerage income	72,390,615	
Interest income ($533,212 + $461,306 + $1,474,560)	2,469,078	
		74,859,693
Assessable profits		113,002,430
Less: Profits already assessed		38,142,737
Additional assessable profits		74,859,693
Additional tax payable thereon		13,100,447

(We observe here that the amounts of ' interest income' set out in this (additional) assessment appear to have omitted a figure of $116,582 which the

Taxpayer received from Company A during the year of assessment 1992/93 as set out in fact (12) of the Determination.)

Year of assessment 1993/94 (additional)

	$	$
Profits per computation		41,695,360
Add: Offshore brokerage income	114,360,453	
Interest income ($348,315 + $177,547 + $4,920,466)	5,446,328	
		119,806,781
Assessable profits		161,502,141
Less: Profits already assessed		41,695,360
Additional assessable profits		119,806,781
Additional tax payable thereon		20,966,186

Year of assessment 1994/95

	$	$
Profits per computation		31,057,967
Add: Offshore brokerage income	102,755,459	
Interest income ($399,481 + $1,409,692)	1,809,173	
		104,564,632
Assessable profits		135,622,599
Tax payable thereon		22,377,728

(13) The Taxpayer, through its tax representative, objected to the additional assessments. Since then, the assessor had revised the additional assessments as follows:

Year of assessment 1992/93 (additional)

	$	$
Profit per profit and loss account		76,416,903
Less : Offshore deposit interest	7,111,139	
Dividend, unclaimed and received	628,340	7,739,479
		68,677,424
Add : Depreciation charged	7,429,202	
Disallowable ' sundry' expenses	659,821	
Loss on disposal of fixed assets	781,322	8,870,345
		77,754,769
Less : Revenue item capitalised	139,194	
Depreciation allowances	8,024,949	8,164,143

Assessable profits		69,383,626
Less : Profits originally assessed		38,142,737
Additional assessable profits		31,240,889
Additional tax payable thereon		5,467,156

Year of assessment 1993/94 (additional)

	$	$
Profit per profit and loss account		136,831,855
Less : Offshore deposit interest	20,314,166	
Dividend, unclaimed and received	108,913	
Profit on disposal of fixed assets	633	20,423,712
		116,408,143
Add : Depreciation charged	1,541,761	
Disallowable ' sundry' expenses	17,301	
Disallowable legal fees	175,560	
Disallowable donations	172,748	
Balancing charge	5,553,166	7,460,536
Assessable profits		123,868,679
Less : Profits originally assessed		41,695,360
Additional assessable profits		82,173,319
Additional tax payable thereon		14,380,331

Year of assessment 1994/95

	$	$
Profit per profit and loss account		127,315,501
Less : Offshore deposit interest	23,753,239	
Dividend, unclaimed and received	74,156	23,827,395
		103,488,106
Add : Disallowable ' sundry' expenses	68,964	
Disallowable legal fees	1,397,264	
Disallowable donations	28,108	1,494,336
		104,982,442
Less : Depreciation allowance		11,708
Assessable profits		104,970,734
Tax payable thereon		17,320,171

(14) The Determination confirmed the amounts of additional tax payable for each of the Relevant Years of Assessment.

Interest income

(15) During the Relevant Years of Assessments, the Taxpayer had received interest income for financing purchase of shares. The Taxpayer claimed that a portion of

that income was received for financing purchases of overseas shares and not taxable. The portion claimed to be non-taxable was arrived at by applying the ratio of overseas brokerage versus total brokerage to the total amount of interest received. The amounts of interest received and the amounts claimed as non-taxable are as follows:

Payer		**1992/93** $	**1993/94** $	**1994/95** $
Company D	Taxable	333,241	117,862	122,196
	Non-taxable	533,212	348,315	399,481
Company E - Tokyo	Taxable	288,302	60,078	0
	Non-taxable	461,306	177,547	0
Company A	Taxable	0	0	0
	Non-taxable	116,582	0	0
Company I	Taxable	0	0	45,273,000
	Non-taxable	0	0	0
Clients	Taxable	921,553	1,664,966	431,205
	Non-taxable	1,474,560	4,920,466	1,409,692
Clients' margin account	Taxable	0	382,284	5,125,937
	Non-taxable	0	0	

(16) Interest income from Company D and Company E - Tokyo office represented interest charged for financing purchases of shares on behalf of New York and Tokyo clients. Interest income from Company A and Company I represented interest charged for advances made to the payers for financing their operations.

Corporate finance income

(17) Included in the Taxpayer's commission income for the year of assessment 1994/95 was an item described as 'corporate finance and underwriting income' in the amount of $50,393,773. In its proposed profits tax computation, the Taxpayer claimed that 50% of this amount was for Hong Kong market and 50% was for overseas market. The Taxpayer's representative claimed that this income was derived from a number of equity capital market projects ('ECM') undertaken throughout the Asia Pacific region in conjunction with an affiliated company, Company N. It was further claimed that:

(a) Company N offered its customers corporate advice, structuring and implementation related to capital market activities such as initial public

offerings, new share issues and issue of warrant. Services of this nature are known within Company N as ECM products.

(b) In many instances, Company N was able to secure the mandates from the customers because of its connections with the Taxpayer. This allows Company N to offer customers a more complete service, since the Taxpayer has well established broking contacts enabling it to place and distribute the equity securities being issued by Company N' s customers.

(c) Company N' s role was to arrange and manage the deals and perform any corporate finance or underwriting activities that may be required. Company N sub-contracted to the Taxpayer any securities distribution or settlement functions and the provision of any market research material that may be required.

(d) Company N paid the Taxpayer a fee for performing these services. In the year ended 31 December 1994, this fee was the $50,393,733 detailed in the Taxpayer' s tax computation.

(e) The services for which the Taxpayer was remunerated were performed by its network of offices and affiliated companies around the Asia/Pacific region and not just Hong Kong. The functions involved will be carried out in intimate conjunction with the Taxpayer' s normal stockbroking activities. Thus, it is not possible to specifically identify activities which directly and solely relate to the fee income derived from Company N.

(f) It was accordingly appropriate to apportion the corporate finance income between onshore and offshore activities on the same basis as the onshore/offshore income earned from the main stockbroking business.

Inter-company commission, management fees, administrative fees

(18) During the Relevant Years of Assessment, the Taxpayer *received* management fees from the following related companies:

	Name of Company	**1992/93 year ended 31-12-1992** $	**1993/94 year ended 31-12-1993** $	**1994/95 year ended 31-12-1994** $
(a)	Company C	98,565,542	101,000,000	115,100,000
(b)	Company D	19,702,000	21,699,812	5,627,152

(c) Company E	6,718,000	0	0
(d) Company B	9,120,000	9,580,027	12,040,044
(e) Company F	0	0	9,028,500
Total	134,105,542	132,279,839	161,795,696

Management fees received from Company C and Company F were treated as wholly arising in or derived from Hong Kong. Management fees received from the other three companies represented expenses incurred by these companies for services rendered by the Taxpayer to these companies in Hong Kong. These were also treated as fully taxable.

(19) During the Relevant Years of Assessment, the Taxpayer *paid* commission, management fees or administration fees to the following related companies:

(A) Commission paid

Name of company		**1992/93 year ended 31-12-1992** $	**1993/94 year ended 31-12-1993** $	**1994/95 year ended 31-12-1994** $
Company C	HK market	100,751,144	113,140,545	137,717,698
	Overseas markets	0	0	0
Company D	HK market	37,906,546	27,107,616	31,423,688
	Overseas markets	22,832,881	67,991,027	87,918,658
Company B	HK market	704,121	1,224,173	275,929
	Overseas markets	6,785,223	34,426,136	34,321,852
Company F	HK market	0	0	0
	Overseas markets	752,405	0	0

(i) Commission paid to Company C was for transactions executed in the Hong Kong market.

(ii) Commission paid to Company D and Company B represented all commission earned from businesses referred by these two companies. The Taxpayer did not derive any net profit from these transactions as the full commission earned was paid back to these

two companies by way of commission, management fees and administrative fees.

(B) **Management fees paid**

Name of company	1992/93 year ended 31-12-1992	1993/94 year ended 31-12-1993	1994/95 year ended 31-12-1994
	$	$	$
Company A	1,143,529	93,825	3,204,382
Company D	60,739,427	95,098,643	19,342,346
Company G	24,530,927	11,469,268	0
Company B	20,707,984	48,433,066	52,909,508
Company F	6,438,900	1,810,907	0
Company H	0	6,952,050	26,144,595
Company I	0	4,000,000	14,000,000
Company G2	0	0	8,554,763
Company J	0	0	11,820,487
Company K	0	0	7,281,929
	113,560,767	167,857,759	243,258,010

(i) Company A and Company F carried on the business of stock broking. Management fees paid to these companies were for reimbursing their costs of providing research work in their respective markets.

(ii) Company G also carried on the business of stock broking. Company G2 was the same company under a new name. Management fees were paid to Company G/Company G2 for them to run the London desk.

(iii) Company H carried on the business of investment holding. Management fees paid to this company represented the Taxpayer's share of expenses incurred for corporate finance projects and share of the execution fees.

(iv) Company I carried on the business of providing fixed assets to group companies. Management fees paid to this company were for use of fixed assets provided.

(v) Company J carried on the business of banking. The fees were paid for head office charges for general management and strategic support provided to the Taxpayer.

(vi) Company K carried on the business of stock broking. The fees represented the Taxpayer' s share of salaries and other expenses of the sales staff based in Japan.

(C) **Administration fees paid**

Company	**1992/93 year ended 31-12-1992** $	**1993/94 year ended 31-12-1993** $	**1994/95 year ended 31-12-1994** $
Company B	13,218,640	12,782,757	18,311,727

Company B carried on the business of stock broking. The administration fees were paid for the provision of information on the Singapore market.

The issues in this appeal

5. At the hearing, we sought assistance from the parties to frame the issues which the Board was required to determine, and the assessable profits (if any) that would result from the Board' s decision on each of the issues. We were then told that this could be done without too much difficulty. After the conclusion of the hearing, the clerk to the Board received a letter dated 11 February 2000 from the Taxpayer' s representative which set out the Taxpayer' s formulation of the issues as follows:

(1) in respect of each of the Relevant Years of Assessment

(a) Did the commission income of the Taxpayer arising from execution of transactions on stock exchanges overseas arise in or derive from a source located outside Hong Kong?

(b) Did the Taxpayer' s interest income arising to the Taxpayer for sums advanced to clients in New York, Tokyo and elsewhere, to finance purchases of shares listed on overseas stock exchanges, arise in or derive from a source located outside Hong Kong?

(c) Did interest income received by the Taxpayer for advances made to Company A and offshore dealers and brokers for the purpose of financing their operations, the credit being provided outside Hong Kong, arise in or derive from a source located outside Hong Kong?

(2) in respect of the year of assessment 1994/95

(d) Did the placement fees (described in the computation as ' underwriting commission') received by the Taxpayer for researching and placing securities listed on overseas stock exchanges, arise in or derive from a source located outside Hong Kong?

Appended to the letter were charts and tables of figures which, it was said, were agreed between the parties to follow from our determination on the issues. Although the Taxpayer' s representative labelled the above as ' agreed issues' , it appears from the letters dated 8 February and 11 February 2000 from the Commissioner' s legal representatives that all that the Commissioner agreed was that there were three broad issues (that is, the source of the commission income, the source of the interest income and the source of the corporate finance income), and no agreement appears to have been reached over the wording of the issues. There was no agreement on the figures either. The letter of 8 February 2000 from the Commissioner' s representative stated that:

> ' As far as calculations are concerned, the Commissioner does not wish to give any comments except to point out that the Commissioner had considered the following expenses in his Determination but decided that they should be disallowed.'

Reference was then made to legal fees and donations. In the event, we are left to do the best we can in identifying the issues raised by this appeal.

6. We should make the following observations:

As regards commission

(1) We have mentioned above that the group has subsidiaries and offices in various parts of the world. We have sought information on which particular subsidiaries or offices brought in the orders that generated the commission income in issue. It appeared to us that this information would have enabled us to focus on the evidence as to the transactions which actually produced the income in question. It would also have prevented us from being sidetracked by irrelevancies. We note, for example, that the Determination contained the following statement:

> ' Regarding orders referred to the (Taxpayer) by Company D and Company B, the (Taxpayer) admitted the whole of the commission was returned to these companies by way of management fees or administration fees and it did not make any profit. If that is the case, I do

> see (sic) the need to consider the offshore claim relating to transactions referred from these companies.'

When asked about this, Mr Thomson told us that this was not an issue in the appeal. At a later part of the hearing, Mr Thomson produced three tables entitled ' Analysis of Commission Income by Office' for each of the years in 1992, 1993 and 1994 (' the Tables'). The Tables set out figures in Hong Kong dollars in respect of ' Hong Kong market' and ' Overseas market' against offices at different territories. We note that the figures in the Tables *include* figures for New York and Singapore. The Tables also gave a breakdown between Hong Kong clients and overseas clients. None of these figures have been agreed between the parties.

(2) Before us, Mr Thomson for the Taxpayer argued that *all* the commission profits in question were offshore whereas Mr Chan, SC for the Commissioner argued that the Taxpayer had not proved its case. During the course of the hearing, it appeared to us that there was at least a possibility that on a proper understanding of the facts, only some but not all of the commission profits in question were offshore. In particular, the evidence showed that the commission profits in question (although all generated from transactions executed at overseas markets) were generated partly from orders placed in Hong Kong by Hong Kong customers and partly from orders placed outside Hong Kong by overseas customers. However, because of the respective positions taken by each side, we have not had the benefit of much assistance on whether these different orders should be treated in the same way for the purpose of determining the source of the profits. We shall revert to this later; but it seems to us that in identifying the issues in this appeal, one ought to differentiate between the two types of transactions and pose the following questions:

(a) whether the commission which the Taxpayer earned during the Relevant Years of Assessment from orders placed in Hong Kong by clients in Hong Kong on overseas market arose in or was derived from a source outside Hong Kong,

(b) whether the commission which the Taxpayer earned during the Relevant Years of Assessment from orders placed by its overseas clients outside Hong Kong on overseas market arose in or was derived from a source outside Hong Kong.

As regards the interest and the corporate finance income

(3) As for the interest and the corporate finance income, the questions we have to ask ourselves are: whether the interest and the corporate finance income, the amounts of which we have set out in paragraphs (15) and (17) above, were income which arose in or were derived from a source outside Hong Kong, or whether they arose partly in Hong Kong and partly outside Hong Kong; and if so, whether they ought to be apportioned, and if so, how.

The evidence

7. The Taxpayer called two witnesses, viz Mr O, the chief financial officer and Mr P, the group head of sales. We accept their evidence as to primary facts and set out our findings on the basis of their evidence below.

(1) The Taxpayer had virtually no retail clients. Its clients were almost exclusively major financial institutions. The structure of the Taxpayer's business was geared towards satisfying the needs of the institutional investors.

(2) Institutional investors demand quality in research and quality in execution. These are what the Taxpayer sells and what the clients would pay for. The fees which the Taxpayer charged its clients were much higher than what a discount broker would charge by way of brokerage.

(3) In terms of business structure, the Taxpayer had three main business areas: research, sales and execution. The group had major offices located in New York, London, Hong Kong, Singapore and Tokyo.

(4) The Hong Kong office was the regional head office. A number of additional functions such as management, group accounting, control, compliance, information technology and human resources were situated here. Hong Kong also had a research team and a sales team. The sales team would contact clients almost every day for marketing and for solicitation of business.

(5) Execution of the orders at the overseas market was performed either through a local broker or, in the case of Taiwan and Indonesia, through a locally incorporated subsidiary or branch to trade in the market. The quality of the execution of clients' order was very important. Execution of a substantial order placed by an institutional client required skill and judgment. This must necessarily be done at the overseas market at which the relevant shares were traded.

(6) The quality of the research was also important. Research analysts would receive a ranking for their performance, and this may often have a significant effect on the size of business generated.

(7) A regional office, such as the Jakarta office, had staff engaged in research. These researchers produced all the research on the Indonesian market. To obtain the necessary information for their research, the researchers made site visits to the companies which were the subject of their research, and talked to management competitors and clients. Their research product would be sent to Hong Kong where it would be edited and collated with materials from other offices for circulation to clients. Editing done at the Hong Kong office includes checking for grammatical and typographical errors, as well as ensuring that the recommendations or wordings were within the bounds of what international regulators would accept. The Hong Kong office also undertook macro-economic analysis in the region (other than Japan). The results would also be incorporated in the research materials distributed to the clients. Generally, the management role for the research function was conducted in Hong Kong.

(8) Research analysts would produce research that stimulated interest and response from clients. They would also maintain constant liaison with the group' s clients or potential clients. This involved their paying frequent visits to the clients, including visits to Hong Kong.

(9) Each client would sign a ' Client Agreement and Client Account Opening Form' with the Taxpayer, although it appears that a US client would also sign an agreement with the US entity of Company D. Clause 4 of the Client Agreement provides under the heading ' commission' :

> ' In consideration of the Broker carrying out transactions in securities pursuant to instructions received by the Broker under this Agreement or for the Account, the Client agrees to pay the Broker commission at such rate or rates and on such basis as it may from time to time have notified the Client, whether orally or in writing, as being the rate or rates applicable to the Account...'

(10) Each country also had its own customer liaison or sales team. Some teams cover the whole region. Thus, the London team would cover the whole of Europe. The teams contact their clients, usually on a daily basis, to draw attention to the group' s research publications that may be of particular interest to that client, discuss market activity and solicit orders. The development and daily maintenance of customer relationship was not only another facet of the

operations leading up to the sales contract, but in many instances was the actual point at which each sales contract was made.

(11) For Hong Kong clients, the processing of an order for execution in an overseas market typically took the following course:

(a) Hong Kong client placed order by telephone to the Hong Kong office. This order may have been generated as a result of the effort of the sales team in Hong Kong or of the research analyst maintaining his liaison with the Hong Kong client. (The Hong Kong client may also call the overseas office direct.)

(b) Hong Kong office relayed the order by telephone to the overseas office or (in cases where there was no overseas office) to an overseas stockbroker.

(c) Overseas office would manage the order by having it executed through local brokers at the overseas market.

(d) Overseas office would report back to Hong Kong office on execution.

(e) Hong Kong office prepared bargain slip to record details of the transaction.

(f) Hong Kong office informed client of the execution of his order by telex.

(g) On the instructions of the overseas office, the overseas broker sent written confirmation of the execution of the order to the Hong Kong office by fax or telex.

(h) Hong Kong office issued a confirmation to the client.

(i) Hong Kong office issued telex instructions to the overseas independent settlement agents (mainly banks) who performed the settlement with the overseas settlement representatives of the client.

(12) For overseas clients, the processing of an order for execution in an overseas market typically took the following course:

(a) an overseas client, say in New York, placed an order to the overseas office in New York for the sale/purchase of shares (say) on the Thailand market,

(b) New York office sent an order sheet to Hong Kong office to advise its receipt of a client' s order and a copy of the order sheet was faxed to the Thai office for execution,

(c) After receipt of the copy order sheet, Thai office would check the market situation and place the order at the market through a Thai broker. Thai office would phone back to the Hong Kong office to report execution.

(d) Hong Kong office prepared a bargain slip to record details of the transaction.

(e) Hong Kong office informed New York office the execution of the client' s order by telex.

(f) New York office would then notify client the execution of its order by phone/fax.

(g) Thai office sent written confirmation of execution of the order to Hong Kong office by fax.

(h) Hong Kong office issued a confirmation to the client.

(13) Broadly speaking, whilst the execution and settlement of the orders necessarily took place outside Hong Kong, all the back office functions such as confirmation of transaction, accounting etc. were carried out in Hong Kong.

The law

8. Three conditions must be satisfied before a charge to tax can arise under section 14 of the IRO. (1) The Taxpayer must carry on a trade, profession or business in Hong Kong. (2) The profits to be charged must be from such trade profession or business, that is, the trade, profession or business carried on by the Taxpayer in Hong Kong. (3) The profits must be ' profits arising in or derived from' Hong Kong: Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306, 318.

9. The parties are *ad idem* as to the broad guiding principle which applies in the present case, namely, that one looks to see *what* the taxpayer has done to earn the profits in question and *where* he has done it [see HK-TVBI v Commissioner of Inland Revenue [1992] HKTC 468 per Lord Jauncey of Tullichettle at page 477.] Mr Chan, SC points out, and we accept, that it is important to focus on what the *taxpayer* - and not what other person or entity - has done, see

Commissioner of Inland Revenue v Wardley Investment Services (Hong Kong) Ltd (1992) 3 HKTC 703 at 729 per Fuad JA.

10. In the HK-TVBI case, Lord Jauncey observed at page 480 that:

> ' *In the view of their Lordships 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...'*

11. Mr Chan, SC further relied on Barnett J' s observation in Commissioner of Inland Revenue v Euro Tech (Far East) Limited (1995) 4 HKTC 30 at page 56:

> ' *It seems to me that Lord Jauncey was doing no more than state what is a common sense. If a taxpayer has a principal place of business in Hong Kong, it is likely that it is in Hong Kong that he earns his profits. It will be difficult for such taxpayer to demonstrate that the profits were earned outside Hong Kong and therefore not chargeable to tax.'*

12. Reference has also been made to Commissioner of Inland Revenue v Hang Seng Bank [1991] 1 AC 306, 322H per Lord Bridge:

> ' *...the question whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always in the last resort a question of fact depending on the nature of the transaction. It is impossible to lay down precise rules of law by which the answer to that question is to be determined. The broad guiding principle, attested by many authorities, is that one looks to see what the taxpayer has done to earn the profit in question. If he has rendered a service or engaged in an activity such as manufacture of goods, the profit will have arisen or derived from the place where the service was rendered, or the profit making activities carried on.'*

A little later on, Lord Bridge observed:

> ' *There may, of course, be cases where the gross profits deriving from an individual transaction will have arisen in or derived from different places. Thus, for example, goods sold outside Hong Kong may have been subject to manufacturing and finishing process which took place partly in Hong Kong and partly overseas. In such a case the absence of a specific provision for apportionment in the Ordinance would not obviate the necessity to apportion the gross profit on sale as having arisen partly in Hong Kong and partly outside Hong Kong...'*

This suggests that in appropriate cases, it may be necessary to apportion the profits by reference to their source, and only that part of the profits which arise in or are derived from Hong Kong should be subject to profits tax. Lord Bridge did not, however, define the circumstances which permit an apportionment exercise, as it was unnecessary in the Hang Seng Bank case.

Taxpayer's arguments

13. Mr Thomson contended that the Taxpayer was a research brokerage. He argued that it was the quality in research and the efficiency in the execution of orders which, on the Taxpayer's case, brought in the commission. Both of these activities were offshore. In connection with this submission, it is an important part of the Taxpayer's case that the overseas offices and brokers acted as agents of the Taxpayer in executing clients' orders at the overseas market.

14. Mr Thomson argued that the contract entered into with customers did not generate the profit. He referred us to the cases of IRC v Hong Kong & Whampoa Dock Company Ltd (1960) 1 HKTC 85 and Magna Industrial Co Ltd v CIR [1996] 4 HKC 55 at 59F. Neither did the performance of the back office or other functions (such as human resources, IT, legal) by the Hong Kong office. These activities account for the need of a large office, but only went to increase the Taxpayer's expense, rather than its revenue.

15. Mr Thomson's case was that both the interest income and the corporate finance fee income ought to be apportioned. Further, his case was that the apportionment should follow the same ratio as the apportionment of the commission.

The Commissioner's arguments

16. Mr Chan, SC identified various matters which, he contended, are the operations of the Taxpayer relating to the transactions in overseas markets. These include: opening of account, marketing, receiving order, placing of orders and communication with overseas brokers, arranging cross-deals between customers, customer accounting and documentation, settlement, accepting responsibility for loss on dealing in securities, offering forex facilities to customers and provision of research.

17. Mr Chan drew our attention to the fact that the Taxpayer had paid 'management fees' and 'administration fees' for research work and information provided by the offices in Taiwan, Singapore and Indonesia. He also argued that the fact since we must focus only on what *the Taxpayer* did, the fact that the execution of the orders were done in the overseas market was irrelevant because execution was not done by the Taxpayer, and the overseas brokers received their commission for such work. He contended that the Taxpayer had simply failed to call evidence to prove that the overseas office or brokers acted as the Taxpayer's agent in carrying out the orders.

18. As for interest income, Mr Chan argued that there was simply no evidence to prove that the credit was provided outside Hong Kong, bearing in mind that:

(1) the financier (that is, the Taxpayer) was in Hong Kong,

(2) the client agreement was made in Hong Kong and was governed by Hong Kong law,

(3) there was no evidence that the borrowers or most of them were overseas customers,

(4) not a single document had been produced to prove that credits were provided outside Hong Kong.

19. On the corporate finance income, Mr Chan's submission was that there was no or insufficient evidence to show that the corporate finance fee was offshore. In particular, there was no evidence of what the Taxpayer had done as regards the placing of shares. There was not even evidence of who the places were, let alone where they were.

Our conclusions and reasoning

Commission from overseas clients

20. We shall first consider the position of commission earned from execution of orders in the overseas market from clients *outside* Hong Kong. The clients may be in London, and the markets at which the orders were executed may have been Thailand, Taiwan or Singapore. We ask ourselves what did the Taxpayer do to earn such commission, and where did the Taxpayer do it?

21. What directly brought in the commission was the execution of an order placed by a client. But this would in turn have been the result of

(1) building up and maintaining a relationship with the client,

(2) providing quality research and offering advice to the client on the market generally and any stock in particular,

(3) providing an efficient and reliable service, not only in the execution of the orders, but generally in managing the client's account, and

(4) projecting and maintaining an image of repute and reliability.

22. In seeking to answer the question posed by Atkin LJ in F L Smith v Greenwood [1921] 3 KB 583 at 593, namely: ' where do the operations take place from which the profits in substance arise?' or the question formulated by Lord Jauncey in HK-TVBI of what the taxpayer has done to earn the profits in question and where did he do it, we do not think it right to limit the inquiry only to the execution of the order. Indeed, neither party urged us to take such a narrow view. If the inquiry should not be confined to the execution of the order, it seems to us that we should take into account all the matters set out in the preceding paragraph.

23. In the context of the question what *Taxpayer* did, we should deal with a submission made by Mr Thomson that the overseas offices and brokers were acting as agents for the Taxpayer in obtaining clients' orders and in executing clients' orders. He argued that those acts should be treated in law as the Taxpayer's acts. Mr Chan retorted that there was no evidence of such agency. This matter was argued at a very late stage and it is correct to observe that there was no direct evidence on this question. The Taxpayer had not adduced any evidence as to the contractual relationship between the Taxpayer and the various offices or its associated companies within the group. We should add that in his Determination, the Commissioner appears to have proceeded on the basis that both the offshore offices and the local brokers were the agents of the Taxpayer for the purpose of executing the orders. Thus, paragraph 3(4) of the reasons stated:

> ' From a narrower prospective, it is clear from the documents under Appendices D1, D2, D3, E1, E2 and E3 that commission was earned when customers' orders were carried out by the [Taxpayer] through agents in the stock exchanges outside Hong Kong. These agents might be entities related or unrelated to the [Taxpayer]...The [Taxpayer] in these transactions received 1% as commission from customers and paid the overseas agents a lower percentage, ranging from 0.4% to 0.75%. The profit to the [Taxpayer] was the difference between what it charged the customers and what it paid the agents to execute the orders...'

Mr Thomson had specifically relied on this paragraph in his opening submissions, with no demur from Mr Chan. In these circumstances, the absence of direct evidence of the contractual relationship between the Taxpayer and the overseas offices is explicable, and may well be the result of the absence of a procedure for exchange of pleadings or the framing of issues in such appeals.

24. It may well be that the group had organized its affairs in such a way that all the profits (other than those generated from orders brought in by Company D and Company B) arising from trading in the Asian market would go to the Taxpayer, presumably because Hong Kong has a low standard tax rate. The problem remains that we have no evidence of the arrangements between the Taxpayer and the other companies or offices in the group. We are conscious, of course, that the Taxpayer bears the burden of proving that the assessment appealed against is erroneous or excessive: see section 68(4) of the IRO.

25. Nevertheless, we are left with the fact that (apart from orders brought in by Company D and Company B), the Taxpayer was able, during the Relevant Years of Assessment, to earn commission from its clients through orders placed by clients with overseas offices. For the reasons we gave in paragraph 23 above, we do not consider that the absence of direct evidence indicates that the Taxpayer was unable to produce such evidence. In the circumstances, we consider it right to draw the inference that the Taxpayer engaged the overseas offices as its agents to perform the task of liaising with clients including soliciting and handling of clients' order.

26. As regards the actual execution of the order, we are not able to draw a similar inference. The orders were executed at the overseas market mostly by local brokers. (Mr O' s evidence was that at the relevant time, only the Seoul office had a membership status.) These brokers would have charged their own commission, and there is no evidence or indeed any suggestion that this was in turn charged to the client as a disbursement. These local brokers were thus only engaged by the relevant office as independent contractors in carrying out the orders at the market. For this reason, we do not think that it would be right to regard the actual execution of the order at the market as the act of the Taxpayer.

27. As far as research materials were concerned, we only know that the Taxpayer had paid management fees to Company A, Company F and Company B to reimburse their costs of providing research work. We do not know the actual arrangement between the Taxpayer with these companies, or indeed, with the other companies or offices which had staff undertaking research, that is, those in Korea, Thailand, Malaysia and India. The Hong Kong office was responsible not only for editing and checking the contents of the research for consistency, but also for the macro economic analysis of the region and generally in managing the production and publication of the research materials.

28. In all the circumstances, and on the evidence we have seen and heard, we have come to the conclusion that the source of the commission generated from overseas clients was substantially offshore. In coming to this conclusion, we do not overlook the fact that some of the Taxpayer' s activities in Hong Kong would have contributed to the making of those profits. For example, the involvement of the Hong Kong office in the collation and publication of the research materials is one factor. The provision of other essential support functions could also be said, albeit indirectly, to have contributed to the success of the Taxpayer in generating the profits it did during the Relevant Years of Assessment. Nevertheless, any such contribution we regard as minor and indirect. Having regard to the other matters which the Taxpayer did through its agents, which were clearly outside Hong Kong, such as the maintenance of the relationship with the client, the processing, handling and management of the orders and the provision of the primary research materials, we consider that the profits generated from orders from overseas clients arose substantially from an offshore source.

Commission from Hong Kong clients

29. As regards commission earned from execution of orders in the overseas market from clients *within* Hong Kong, these are, again, directly the result of the execution of the orders placed by the clients, which would in turn have been the result of the Taxpayer' s efforts in building up and maintaining the relationship with the clients, providing quality research and offering advice to the clients, providing an efficient and reliable service to the clients and in projecting and maintaining an image of repute and reliability to the clients. But here, the presence of the Hong Kong office, the efforts of the Hong Kong sales team and the visits which the research analysts from different regions calling upon the Hong Kong clients in Hong Kong would appear to us to be the substantial reason why the Taxpayer was able to generate the profits it did during the Relevant Years of Assessment. All these activities were carried out by the Taxpayer in Hong Kong. At the same time, we are satisfied that there were foreign elements which contributed to the production of these profits. In particular, the order had to be managed overseas, and the basic research was performed overseas. In our view, the profits earned from execution of orders from Hong Kong clients on overseas market can truly be said to be derived from operations carried out both within and outside Hong Kong. In these circumstances, we need to consider whether apportionment of the profits is possible. Mr Thomson' s position before us was that if the source of profits were to be identified as both onshore and offshore, the Board would have a duty to apportion the profits. Mr Chan' s position, however, was that any apportionment could only be based on facts and figures, and that because the Taxpayer had failed to produce any evidence as to how much of the profits in question arose outside Hong Kong, the appeal ought to be dismissed.

Does the law allow or require apportionment?

30. Does the law allow or require apportionment when the profits arise in or are derived from a multi-source; that is to say, both from Hong Kong and from some outside source? This is not an easy question.

31. Earlier Hong Kong cases suggest that apportionment is not possible. See Hong Kong and Whampoa Dock Co Ltd [1960] HKLR 166 at page193-4 per Reece J:

> ' *In the passage just quoted from the judgment of Dixon J in Commissioner of Taxation (NSW) v Hillsdon Watts Ltd I would particularly emphasise the statement that it is impossible to dissect the sum realized and attribute separate parts to places where the respective stages of the operations are completed and the total profit is an inseparable whole obtained as the indiscriminate result of the entirety of the operations, the locality where it arises must be determined by considerations which fasten upon the acts more immediately responsible for the receipt of the profit. This is of the utmost significance in the case before us where part of the services rendered were performed within the territorial waters of Hong Kong but where, unlike New South Wales, we have our income-tax legislation which makes no provision for apportionment of income.'*

See also CIR v International Wood Products Ltd (1971) 1 HKTC 551 at 570.

32. Thus, when the Court of Appeal came to decide CIR v Hang Seng Bank Ltd [1989] 2 HKLR 236, the Court held that apportionment was not possible. Cons VP said (at page 243):

> ' *The hypothetical answer foreshadows the next question, for Hong Kong legislation makes no provision for the geographical apportionment of profit. The Board of Review is required to ascribe to it only one location. In Hong Kong and Whampoa Dock Co Ltd at page 193-4 Reece, J approved the suggestion of Dickson, J in Commissioner of Taxation (NSW) v Hillsdon Watts Ltd (1936) 57 CLR 36 that in the circumstance, that is where the profit is derived from more than one location, "the locality where it arises must be determined by considerations which fasten upon the acts more immediately responsible for the receipt of the profit". (There was much argument before us as to whether "immediately" was intended to refer to tome or space.) My Lord Clough will prefer a need to identify "a dominant factor or factors". It seems to me that both expressions contemplate the same underlying concept, which is equally to be found in Lord Atkin's use of the words "in substance" in Smith v Greenwood.'*

We have noted above that when the case reached the Privy Council, Lord Bridge said at [1991] 1 AC 323B that

> ' *[t]here may, of course, be cases where the gross profits deriving from an individual transaction will have arisen in or derived from different places. Thus, for example, goods sold outside Hong Kong may have been subject to manufacturing and finishing process which took place partly in Hong Kong and partly overseas. In such a case the absence of a specific provision for apportionment in the Ordinance would not obviate the necessity to apportion the gross profit on sale as having arisen partly in Hong Kong and partly outside Hong Kong...'*

Lord Bridge's observations are of course *obiter*. But it should be noted that:

(a) Lord Bridge was delivering the opinion of the Judicial Committee of the Privy Council, comprising also of Lord Brandon, Lord Griffiths, Lord Ackner and Lord Jauncey, and their opinion was unanimous;

(b) the Privy Council found it necessary to express this view presumably because they disagreed with the Court of Appeal's decision on the impermissibility of apportionment;

(c) In Yates v GCA International Ltd [1991] STC 157 at 172, Scott J expressed the view that the apportionment approach was a ' commonsense approach to the meaning and correct application of ordinary words in the English language' .

33. In D64/91, IRBRD, vol 6, 484, the Board of Review concluded that since Lord Bridge' s observations in the Hang Seng Bank case were *obiter*, the Board was bound by the Hong Kong authorities to the effect that apportionment is not possible. Textbook writers seek to reconcile the authorities by suggesting that apportionment is possible only where the profits realised from operations both within and outside Hong Kong can be apportioned in accordance with the different places where the respective stages of the operations are completed. Conversely, so it is said, apportionment is not possible where the profit in question is an inseparable amount obtained as a result of the entire activity of the taxpayer: see Willoughby & Halkyard, Encyclopaedia of Hong Kong Taxation and Halsbury' s Laws of Hong Kong, volume 24, paragraph 370.182.

34. We respectfully doubt whether the Privy Council' s observations in the Hang Seng Bank case can be confined to cases where the profits can be apportioned in accordance with the different places where the respective stages of the operations are completed. Like Scott J, we would have thought that commonsense would require an apportionment when the tax is levied on source and where the profits are derived from more than one source, both within and outside the jurisdiction. Having read and re-read the opinion of the Privy Council, we believe that they were suggesting a much broader principle of apportionment. It seems to us that whether such apportionment is rendered more easy, or conversely more difficult, because of the factual situation of each case ought not to affect the principle. Nevertheless, we have to conclude, albeit with reluctance, that in the present state of the authorities, we, like the Board of Review in D64/91, are bound by the decisions of the Court of Appeal and cannot make any apportionment.

35. Instead, we have to determine one single source which is the predominant source of the profits, or, in the words of Dickson J in Commissioner of Taxation v Hillsdon Watts Ltd (1936) 57 CLR 36 at 52, the locality where the acts more immediately responsible for the receipt of the profit were conducted.

36. In respect of commission generated from orders given by Hong Kong clients, we are of the opinion that the predominant source, as well as the source where the acts more immediately responsible for the receipt of the profits, was Hong Kong. In coming to this conclusion, we have taken into account all the circumstances we consider relevant. As we have stated above, we do not overlook the fact that the research and the management of the orders took place overseas. However, for the profits in question, the clients were in Hong Kong, the orders which immediately gave rise to the commission were placed in Hong Kong. Although the primary research was carried out offshore, the research materials had to be read and assimilated and these were presented to the clients in Hong Kong, as part of the marketing exercise to generate more orders. This was part of the efforts of the Taxpayer - carried out in Hong Kong - to establish and maintain

close liaison with its clients in Hong Kong. Also, Hong Kong was the place where the group's research was being monitored for its quality.

37. We should add that if the law allows an apportionment, we would have held that it would be for the Board to do the apportionment and the Board must do its best on the evidence before it. In the present case, if we were required to perform the exercise, we would, having regard to the relative importance of the activities of the Taxpayer in and outside Hong Kong to the production of the profits in question, have apportioned the profits derived from commission earned from Hong Kong clients to be 60% onshore and 40% offshore. We have deliberated long and hard over this question, realising that this comes down to a matter of fact and degree. But in the event, for the reasons stated above, we consider ourselves bound to dismiss the appeal in respect of the commission profits generated from Hong Kong clients.

Interest and corporate finance income

38. The Taxpayer was able to earn the corporate finance income because Company N sub-contracted to the Taxpayer the securities distribution for the placing of some eighty-nine different securities. The Taxpayer has produced a list of the securities, but was not able to identify what the places were and where they were located. It has suggested that the corporate finance income should be apportioned between onshore and offshore activities on the same basis as the onshore/offshore income earned from the main stockbroking business which, we were told, would produce 22% local and 78% offshore. We do not see the rationale for apportioning this income on such basis.

39. In our view, the transactions which gave rise to the corporate finance income would have been the agreement it had with Company N as well as its activities in placing the eighty-nine securities with its clients. We have not been shown any evidence that either of these matters took place out of Hong Kong, and accordingly must dismiss the appeal in so far as it relates to the corporate finance income.

40. As for interest income claimed to be non-taxable, part of this was received by the Taxpayer from Company D, Company E representing interest charged for financing purchases of shares on behalf of New York and Tokyo clients. Part of the interest was received from Company A and that represented interest charged for advances made to finance its operations. The remainder of the interest income was received from 'clients' but we were not given any further information what this meant. The Taxpayer urged us to apportion the interest on the basis of overseas brokerage against total brokerage. Again, we see no rational basis for such an apportionment. It is for the Taxpayer to satisfy us that the interest income was derived from a source outside Hong Kong and it has failed to do so. We simply have no evidence as to what the Taxpayer did to enable it to earn the interest income.

Disposal of the appeal

41. In the event, we have come to the conclusion that the Taxpayer has succeeded in only one respect in showing that the assessments appealed against were wrong or excessive, namely, that the commission earned by the Taxpayer from orders generated from offshore clients for execution in overseas markets should have been excluded from the profits tax computation.

42. The tables produced by Mr Thomson showed a breakdown of the commission income from Hong Kong clients and overseas clients during each of the Relevant Years of Assessment. However, since the tables were not adduced in evidence but were only handed up during the hearing, with little or no opportunity for the Commissioner' s representative to check or verify them, it would not be fair for the Board to proceed on the basis that the figures therein are accurate and reliable. Furthermore, we have already observed above that the tables included figures for the Singapore and New York offices, when we were told that the commission generated from these offices had been returned to the respective companies in Singapore and New York by way of management fees or administration fees, so that the Taxpayer did *not* make any profit from transactions generated from these two companies or offices.

43. In the circumstances, we would remit the case to the Commissioner with our opinion that the profits generated from orders placed by clients outside Hong Kong for execution at overseas market did not arise in or were not derived from Hong Kong and are not taxable under section 14 of the IRO.

44. We should record that Mr Chan had submitted that it was the duty of the Taxpayer to put forward all the evidence which could have been produced, so that where the Board was unable to determine how much of the profits in question were offshore, it should simply dismiss the appeal. In our view, this would be stating the burden of the Taxpayer too high. Section 68(4) provides that the onus of showing that the assessment appealed against is excessive or incorrect shall be on the taxpayer. In a case where the taxpayer satisfies the Board that the reasoning of the Commissioner' s determination was wrong, and the Board concludes that the assessment appealed against must be wrong or excessive, the Board' s duty would be to allow the appeal; and this is so even though the taxpayer may not have adduced sufficient evidence to show what the correct assessment should be. That is why the IRO expressly confers power on the Board to remit the case to the Commissioner and requires the Commissioner then to revise the assessment as the opinion of the Board may require.

45. For these reasons, we would allow the appeal to the extent stated above and remit the case to the Commissioner under section 68(8)(a) of the IRO. We also give liberty to the parties to apply for directions under section 68(8)(b) of the IRO.