Case No. D9/88

Profits tax – source of profits – film distribution overseas – taxpayer carried on all his activities in Hong Kong – whether profits arose in or derived from Hong Kong – s 14 of the Inland Revenue Ordinance.

Panel: Charles A Ching QC (chairman), John A Cheetham and Stephen C C Cheung.

Dates of hearing: 15 and 18 December 1986.
Date of decision: 18 May 1988.

The taxpayer company made available the services of a film star to movie producers. The taxpayer took an option in one movie contract to purchase distribution rights for the movie in Taiwan and Thailand. The agreement provided that, should such option be exercised after the producer had commenced distribution of the movie in those countries, the producer would pay the profits from those countries to the taxpayer.

The producer distributed the movie in Taiwan through an associated company. The taxpayer subsequently exercised its option and, in accordance with the contract, the taxpayer received $3,480,983.

The Commissioner assessed this sum to profits tax. The taxpayer appealed, and claimed that the profits were sourced in Taiwan.

Held:

The profits were sourced in Hong Kong and were assessable to profits tax.

The taxpayer did nothing outside Hong Kong in order to earn the profits. The movie was made by the producer, and distributed in Taiwan through its associated company. The result might be different if the taxpayer had performed acts outside of Hong Kong. [Editor's note: this is an application of the 'operations test' for the purpose of determining the source of the profits.]

Appeal dismissed.

Cases referred to:

CIR v International Wood Products Ltd (1971) 1 HKTC 551
CIR v The Hong Kong and Whampoa Dock Co Ltd (1960) 1 HKTC 85

Wan Tsang Yuk Ling for the Commissioner of Inland Revenue.
Thomas Lai of Chan Lai Pang & Co for the taxpayer.

Decision:

In this appeal, the facts as set out in the Commissioner's Determination and in two letters between the Commissioner and A Company dated 2 and 6 April 1984 were agreed. We therefore heard no evidence.

The Taxpayer is a company which was incorporated in Hong Kong in 1971. Its original business was the distribution of motion pictures but, in May 1979, it changed its business to that of providing services in connection with the production of motion pictures. Since that date, its ultimate holding company has been C Company which is controlled by Mr X and Mr Y. The latter is a popular film star. In June 1979, the Taxpayer entered into an agreement in writing with A Company. By it the Taxpayer ('the manager') agreed to provide to A Company ('the producer') the services of Mr Y ('the artist') as an actor and screen director in a feature film. By clause 3 it was provided that:

> 'The producer shall, as remuneration and full consideration pay to the Manager for the services of the said Artist the sum of Hong Kong dollars Five Hundred Thousand Only (HK$500,000). Subject to the Artist successfully completing his services provided for in this agreement the Manager shall be granted the option for the distribution right of the said film for Taiwan and Thailand subject further to payment of the HK$100 by the Manager to the Producer in the exercise of such option. At any time before the option is exercisable and exercised by the Manager, the producer may be itself or authorise other to dispose of the distribution rights of the said film for the said territories or any of them. The liabilities of the Producer is limited to, when such option is exercised, accounting to and paying over all such distribution receipts that might have been receivable to the Manager less such distribution fees and distribution expenses and without liabilities as to damages, loss of profits or otherwise.'

The $500,000 was paid. The Taxpayer paid $400,000 of it to Mr Y and D Company, of which Mr Y was a shareholder and director, for the provision of various services. The film was completed on a date not disclosed to us. It was released in Taiwan. All work for that release was performed by a company in that country called E Company, an affiliate of A Company. At some date and in some manner not disclosed to us, the Taxpayer exercised its option under clause 3 insofar as it related to Taiwan. E Company retained 35% of its receivables and paid to the Taxpayer $3,480,943.57. The Taxpayer was assessed to profits tax on assessable profits in the sum of $3,258,485 and it is against that determination that the Taxpayer appeals.

By its notice of appeal the Taxpayer advanced two grounds. The first was that:

'The Commissioner makes no distinction between
"Film Right" and "Distribution Right of the Film".'

There followed in the notice of appeal a lengthy argument which should have no place in any such notice. The argument sought to draw distinctions between 'Film Rights', 'Film Releases' and 'Distribution Rights'. Whether there be distinctions or not, no evidence was called upon this and these facts were not agreed. It is clear to us that clause 3 provided, inter alia, for an option for the Taxpayer to take over the distribution of the film in Taiwan at its own risk and expense, provision being made for A Company to retain such expenses as it had already incurred. We see nothing in this first point.

The second point advanced was that the $3,258,485 assessed to tax were box office receipts derived outside Hong Kong. There was cited to us such cases as CIR v The Hong Kong and Whampoa Dock Co Ltd (1960) 1 HKTC 85, CIR v International Wood Products Ltd (1971) 1 HKTC 551 and a number of other decisions of the Board of Review. We find this argument misconceived. All of these cases involved taxpayers who had performed acts outside of Hong Kong and the dispute was whether or not the income generated by these acts fell to be assessed to tax in Hong Kong. In the present case, there is neither allegation nor evidence that the Taxpayer ever did anything outside Hong Kong to generate the income assessed to tax. Thus, insofar as the film may have been made outside Hong Kong, it was made by A Company, not the Taxpayer. The release work was performed by E Company and not by the Taxpayer. We were told by Mr Lai who appeared for the Taxpayer that there was no agreement signed between the Taxpayer and that company. No evidence was given of any oral agreement. The Taxpayer entered into the agreement, exercised the option and was paid in Hong Kong.

We therefore dismiss this appeal.