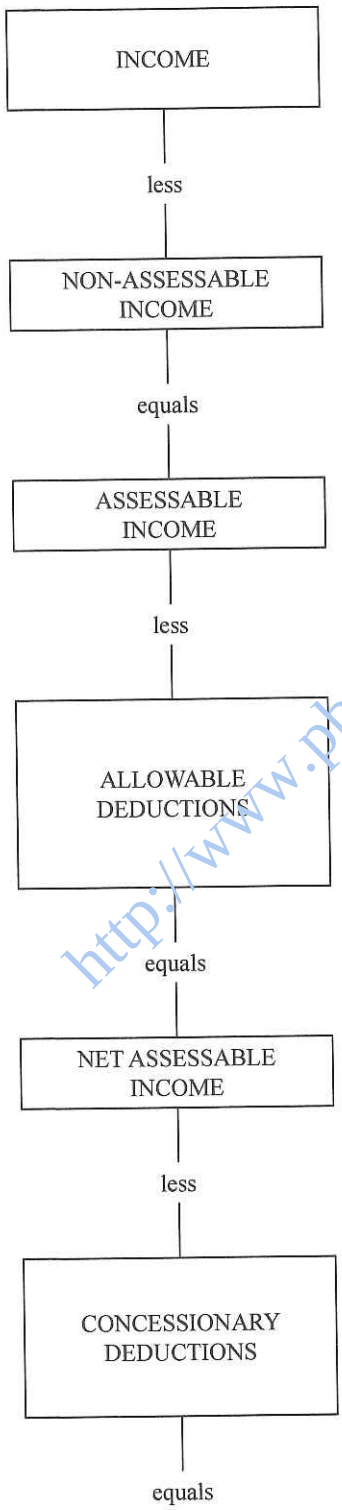
TAX RATES, PERSONAL ALLOWANCES AND TAX DEDUCTION AT A GLANCE

[¶2-0100] Flowchart

The following flowchart demonstrates the process by which a taxpayer's salaries tax liability is determined.



Comprised of all of the taxpayer's Hong Kong-sourced income (¶2-0300ff) from any employment (¶2-2850), office (¶2-2800) or pension.

Any income which has not accrued (¶2-4650) *or* been received (¶2-4700) by the taxpayer.

All outgoings and expenses (other than domestic, private or capital expenditure) wholly, exclusively and necessarily incurred in the production of assessable income (¶2-4950ff); self-education expenses (¶2-5300); depreciation and other capital allowances (¶2-6100); and losses (¶2-6150). Balancing charges are added (¶2-6200).

Concessionary deductions available are: approved charitable donations (¶2-6450), elderly residential care expenses (¶2-6550), home loan interest (¶2-6700), contributions to recognised retirement schemes (¶2-6900).

scheme or mandatory provident fund scheme) to the extent that it represents his or her employer's contributions to the relevant fund, scheme or society (s 9(1)(aa); see ¶2-1950).

- Any amount (other than a pension) received by an employee from a **recognised occupational retirement scheme** other than on termination of service, death, incapacity, terminal illness or retirement, to the extent that it represents his or her employer's contributions to the scheme (s 9(1)(ab)(i); see ¶2-1950).
- Any amount (other than a pension) received by an employee from a **recognised occupational retirement scheme** upon termination of service to the extent that it represents his or her employer's contributions to the scheme in excess of the "proportionate benefit" permitted to be exempt under s 8(5) (s 9(1)(ab)(ii); see ¶2-1950).
- Any amount received by an employee, in accordance with a court order made under s 57(3)(b) of the *Occupational Retirement Schemes Ordinance* (Cap 426) for **any shortfall** in the funding of a beneficiary's benefits, to the extent that the amount is attributable to the employer's contributions to the relevant occupational retirement scheme (s 9(1)(ac); see ¶2-1950).
- Any accrued benefit received or taken to have received by an employee from a **mandatory provident fund scheme** other than on retirement, death, incapacity, terminal illness or termination of service, to the extent that it represents contributions paid to the scheme by the employer (s 9(1)(ad); see ¶2-1950).
- Any accrued benefit received or taken to have received by an employee from a **mandatory provident fund scheme** to the extent that it represents voluntary contributions paid to the scheme by the employer in excess of the "proportionate benefit" calculated under s 8(5) (s 9(1)(ae); see ¶2-1950).
- The **rental value** of any residence provided rent-free by an employer or an associated corporation (s 9(1)(b); see ¶2-2100).
- When a place of residence is provided by an employer (or an associated corporation) at a rent less than the rental value, the **excess of the rental value** over the rent paid (s 9(1)(c); see ¶2-2400).
- Any gain realised by the **exercise of, or by the assignment or release of a right to acquire shares** or stock in a corporation if the right was obtained by virtue of the taxpayer's employment or office in that or any other corporation (s 9(1)(d); see ¶2-2600).
- Any **benefits provided by an employer not in connection with a holiday package and capable of being converted into money** by the recipient (s 9(2A)(a); see ¶2-1550).
- Any **education benefits** paid by an employer for the education of an employee's child (s 9(2A)(b); see ¶2-1600).
- Any amount paid by an employer to an employee in connection with a **holiday journey** (s 9(2A)(c); see ¶2-1630).

DEEMED EMPLOYMENT INCOME

[¶2-0500] Remuneration paid to service company or trust

Remuneration paid to a service company for the services of an individual who controls the company, or whose associate or associates control the company, is deemed to be income

Notification requirements

When an employment relationship is deemed to exist under s 9A, the relevant person and the relevant individual who are deemed employer and employee respectively are required to fulfil all applicable notification and compliance requirements imposed under the *Inland Revenue Ordinance* (Cap 112). In particular, the relevant person must comply with the requirements imposed upon employers under s 52 to give notice of the commencement (and cessation) of the individual's employment and other details (see ¶9-3100ff). Failure to do so is an offence under s 80 (see ¶12-0900).

Agreements to which s 9A applies

Section 9A applies in relation to any agreement under which remuneration for an individual's services is paid or credited, by a person carrying on a trade, profession, business, or prescribed activity, to:

(a) a corporation controlled either by the individual himself or herself, by an associate or associates of the individual, or by the individual together with one or more associates;

(b) a trustee of a trust estate under which the individual, or one or more of his or her associates, is a beneficiary; or

(c) a corporation controlled by a trustee as described in (b) (s 9A(1)(a)–(c)).

The agreement need not be in writing.

Section 9A also applies in relation to agreements which were entered into before 18 August 1995, but only in relation to services carried out and remuneration paid or credited on or after that date.

The scope of s 9A is extremely wide as the term "associate" is broadly defined to mean:

- a relative (ie a spouse, parent, child, brother or sister) of the individual;
- a partner of the individual, or a relative of that partner;
- a partnership in which the individual is a partner;
- any corporation controlled either by the individual; a partner of the individual; or a partnership in which the individual is a partner;
- any director or principal officer of such a corporation;
- any other individual who is also a party to the service company or trust agreement (s 9A(8)).

If an agreement applies to two or more individuals then s 9A(1) applies to them individually, not collectively (s 9A(7)(a)).

[¶2-0550] Section 9A "escape" provisions

To prevent legitimate non-employment arrangements from being deemed employee/employer relationships, section 9A sets out circumstances in which remuneration paid under such arrangements will not be deemed to be income from an employment. The conditions for exclusion from the operation of s 9A(1) are quite strict. It will be difficult for taxpayers to establish that service company or trust arrangements entered into by them are not simply disguised employer/employee relationships.

There are basically three circumstances in which an arrangement will "escape" the operation of s 9A(1):

(i) where all of the key characteristics of an employment relationship are absent (s 9A(3));

rarely apply. It is unlikely that even a taxpayer who genuinely is not an employee would be able to fulfil the stringent requirements of this provision.

Where the Commissioner is satisfied that no employment exists

An individual performing services will not be deemed to be an employee of a person paying the remuneration for those services to a service company or trust if the individual can establish, to the satisfaction of the Commissioner, that his or her performance of services was not in substance the holding of an office or employment of profit (s 9A(4)).

In exercising his discretion under this provision, the Commissioner will have regard to whether or not the individual's performance of services displays the accepted characteristics of an office or employment of profit as opposed to a contract for services, as set down in case law.

See ¶2-2850 for a discussion of the "control test", the "economic reality test" and the "integration test".

On the surface, this provision appears to provide a less stringent avenue for escaping to application of s 9A(1). However, careful consideration of all of the circumstances of the relevant arrangement will be required to determine whether or not an employment relationship exists. In practice, since the Inland Revenue has repeatedly expressed its intention to curtail the avoidance of tax through service company arrangements, the Commissioner is unlikely to exercise his discretion lightly. In order to escape the effect of s 9A(1) under this provision, an individual may be required to establish many, if not all, of the factors required under s 9A(3) (listed above) in order to satisfy the Commissioner that he or she does not hold an office or employment of profit. Note, in this regard, the information required to be provided and the list of questions required to be answered by an individual who requests an advance ruling under s 9A(4).

In *Case* P19 (2006) HKRC ¶31-171 (*D13/06* IRBRD Vol 21), the taxpayer sought to rely on s 9A(4) after failing to satisfy all the six criteria set down in s 9A(3). The Board noted the following facts of the case:

(i) The taxpayer had only one full time job at all material times, being a deputy director or consultant at the hospital. He had committed himself to work exclusively for the hospital for five years.

(ii) The taxpayer received a steady monthly income from the hospital.

(iii) The taxpayer was under the hospital's control and held himself out as its officer.

(iv) The Board was unable to see any real entrepreneurship on the part of the taxpayer due to the absence of any business decision or managerial function to be made by the taxpayer and risk taken by the taxpayer.

By looking at the whole picture, the Board concluded that the relationship in question was one of employment in substance and s 9A(4) was not satisfied.

Where the individual performing the services and the person paying the remuneration are the same

An employer/employee relationship cannot exist when there is only one party involved: a person cannot employ himself. Therefore, for the avoidance of doubt, it is specifically declared that s 9A(1) does not apply where either:

(i) the person paying the remuneration is also the person performing the services; or

(ii) the person paying the remuneration is a partnership and the person performing the services is a partner of the partnership (s 9A(7)(b)).

B. *Integration Test* (to determine whether the relevant individual is holding a position within the organisation of the relevant person).

1. Does the relevant individual represent to third parties that he is a staff member of the relevant person?
2. Does the relevant individual get promotions within the organisation framework of the relevant person?
3. Does the relevant individual have subordinates who are staff of the relevant person?
4. Is the relevant individual part and parcel of the organisation of the relevant person?
5. Is the relationship a continuing one or does it exist only to procure a result?

C. *Economic Reality Test* (to determine whether the income of the relevant individual is in effect derived from the relevant person and whether the relevant individual is at risk with his capital).

1. Does the relevant person provide the equipment or assistants while the relevant individual is performing his duties?
2. Does the relevant individual contribute capital and in what amount? Can the capital be at risk and in what way?
3. How is the remuneration received by the service company from the relevant person computed? How is the remuneration received by the relevant individual from the service company computed?
4. What is the duration of the agreement between the service company and the relevant person? Will the agreement be renewed and on what basis?

The Commissioner in some cases may seek further information from the relevant individual or a third party in order to make an advance ruling.

[¶2-0600] Prevention of double taxation

To prevent the double taxation of income, where an individual becomes chargeable to salaries tax on remuneration deemed to be employment income under s 9A(1):

(i) the corporation or trustee to whom the remuneration was paid or credited is not chargeable to tax on that remuneration; and

(ii) the individual is not chargeable to tax on any remuneration paid or credited to him or her by the corporation or trustee in respect of any office or employment held by the individual with the corporation or trust (to the extent that the remuneration is attributable to services performed under the service company or trust arrangement) (s 9A(5)).

[¶2-0650] Application of general anti-avoidance provisions

The Inland Revenue's view is that, depending upon the facts of the case, an arrangement which falls outside the scope of s 9A may nevertheless be charged to salaries tax by the operation of the general anti-avoidance provisions of the *Inland Revenue Ordinance* (Cap 112) (s 61 and 61A) (DIPN No 25 (Revised), para 58). The Privy Council decision in *CIR v Challenge Corporation Limited* (1987) 2 WLR 24 is cited as authority for the proposition that a general anti-avoidance provision can apply notwithstanding the existence of specific anti-avoidance provisions.

Note, however, DIPN No 25 (Revised), like all DIPNs, is not legally binding and does not affect a taxpayer's appeal rights.

Overseas sales of the products were made by a network of export managers appointed in the taxpayer's overseas sales regions. The export managers appointed distributors and sales were made when the export managers signed contracts, as the taxpayer's agents, with the distributors as purchasers. When orders were received, the taxpayer would purchase products from A Ltd and stock would be shipped from A Ltd's warehouse to the overseas distributors. The taxpayer received payments in Hong Kong, profits from which were assessed to profits tax by the Inland Revenue.

At the first stage of appeal the Board of Review had adopted an "operations test" approach, looking at the "totality of facts" to determine whether Magna's profits arose in Hong Kong (see *Case* E63 (1995) 1 HKRC ¶80-360 (*D10/95* IRBRD Vol 10, 92)). In its case stated, the Board indicated that in determining the Magna case, its deliberation included not only the purchase and sale of products but also all of the relevant facts. According to the Court of Appeal, no criticism could be made of that approach.

Based upon the total facts, the Board concluded that sale of products through the network of overseas contractors was the most important factor and the source from which the profit arose. Although certain activities took place in Hong Kong, such as invoicing, shipping, collecting payment, etc, they were ancillary and not the true source of the profit. The Court of Appeal upheld this finding as sustainable in law and overturned the interim finding of the High Court that the taxpayer's profits were sourced in Hong Kong.

Jerome Chan J of the High Court had also applied an operations test approach, weighing up all the facts of the case (*Commissioner of Inland Revenue v Magna Industrial Company Limited* (1996) HKRC ¶90-078). Chan J's interpretation of the facts, however, was somewhat different from the Board's. The judge considered that the "sourcing" of the Magna's products and the relationship with suppliers in Hong Kong were important factors in the Magna's profit-making activities, and indeed they were. However, while the Board considered that these activities were undertaken by A Ltd, an independent subsidiary of Magna, Chan J's view was that A Ltd was a "mere puppet" of Magna, that A Ltd's separate identity was "artificial" and, therefore, that all of the purchasing activities in Hong Kong were Magna's. This view was firmly rejected by the Court of Appeal. That A Ltd was a mere puppet of the taxpayer was never part of the Commissioner's case and the High Court, therefore, was not entitled to make such a finding.

Macquarie Securities Limited (formerly known as Baring Securities (Hong Kong) Limited) and ING Baring Securities (Hong Kong) Limited)

This is a milestone case in ascertaining the source of profits. The decision handed down by the Court of Final Appeal in October 2007 has provided clear guidance on how to apply the broad guiding principle under the *Hang Seng Bank* case as well as the agency rule. In reaching its decision, the Court of Final Appeal applied the "operations test" and encouraged the departure from the "totality of facts" approach. Other than such reaffirmation of the importance to look into the crucial steps in earning the subject income, the decision also clarifies the less-than-clear agency principle for tax purposes.

It is worth-noting that the Court of Final Appeal commented that the question of source should be determined by the nature and situs of the profit-producing transactions and not by where the taxpayer's business was administered or its commercial decisions were taken. In this case, the Board had applied an incorrect principle and looked for evidence which was largely irrelevant. As a result, the Board had incorrectly ruled that the taxpayer had not discharged its burden of proof.

At the dispute in the case was the tax treatment of three types of income:

(i) commission income;

(ii) placement income; and

Bank. As indicated above, subsequent courts have looked increasingly to a wider range of activities or even the whole operations of a taxpayer's business to identify the source of the taxpayer's profits. Nevertheless, the ruling handed down by the Court of Final Appeal in *Macquarie Securities Limited* v *The Commissioner of Inland Revenue* (2007) HKRC ¶90-195 has reaffirmed the broad guiding principle in *Hang Seng Bank* and clarifies the agency rule for tax purposes.

In an attempt to provide guidance for taxpayers and their advisers, the Inland Revenue Department has set out what it considers are the basic principles for determining profit source in DIPN No 21 (Revised) (see below). However, the Practice Note is not legally binding and, in fact, a statement made by the Commissioner in the original Practice Note was specifically rejected by the High Court in the *Magna* case (see further ¶6-1900). The source of profit issue therefore remains uncertain and open to interpretation.

Inland Revenue Department summary of source of profit principles

In order to clarify some of the uncertainty surrounding the issue of locating the source of profits, the Inland Revenue Department has summarised what it considers are the basic principles arising out of the Privy Council and the Court of Final Appeal decisions in DIPN No 21 (Revised): Locality of Profits (first issued in 1992 and revised in 1996, 1998 and 2009). The basic principles for determining the locality of profits enunciated in the decisions of *Hang Seng Bank*, *HK-TVBI*, *Orion Caribbean*, *Kwong Mile*, *Kim Eng* and *ING Baring* are set out in DIPN No 21 (Revised), para 17:

(i) The question of locality of profits is a hard, practical matter of fact. No universal rule will cover every case. Whether profits arise in or are derived from Hong Kong depends on the nature of the profits and the transactions giving rise to them.

(ii) The ascertainment of the source of profits though a practical, hard matter of fact requires an accurate legal analysis of the transaction.

(iii) The transactions must be looked at separately and the profits of each transaction considered on their own.

(iv) The broad guiding principle is that one looks to see what the taxpayer has done to earn the profits in question and where he or she has done it. In other words, the proper approach is to ascertain what were the operations which produced the relevant profits and where those operations took place.

(v) The operations in question must be the operations of the taxpayer.

(vi) The relevant operations do not comprise the whole of the taxpayer's activities carried out in the course of his or her business but only those which produce the profit in question. It is necessary to appreciate the reality of each case, focusing on effective causes for earning the profits without being distracted by antecedent or incidental matters.

(vii) The distinction between Hong Kong profits and offshore profits is made by reference to gross profits arising from individual transactions.

(viii) In certain situations, where gross profits from an individual transaction arise in different places, they can be apportioned as arising partly in and partly outside Hong Kong (see further ¶6-1820).

(ix) The place where day-to-day investment decisions are taken does not generally determine the locality of profits.

(x) It is necessary to examine the operations of the taxpayer irrespective of the fact that the taxpayer may be a company within a group. The source of profits must be attributed to the operations of the taxpayer which produce them and not to the

which in substance gave rise to the profits were those conducted by the taxpayer's agents in the Philippines and so the profits were not sourced in Hong Kong.

The emphasis in these cases was upon the various operations of the taxpayers leading to net profits, not upon specific gross profit-generating transactions. In the 1985 decision in *Sinolink Overseas Co Ltd v Commissioner of Inland Revenue* (1985) 2 HKTC 127 the operations test was taken even further when the High Court concluded that consideration should be given to all of the activities which collectively produced the taxpayer's profits including pre-contract preparation and management, the making of contracts and post-contract performance and management.

The "operations test" adopted in the *Sinolink* and *Whampoa* decisions was superseded by the "broad guiding principle" set down and applied by the Privy Council in *Hang Seng Bank* which shifted emphasis away from the taxpayer's whole operations and redirected it to the specific, gross profit-generating transactions of the taxpayer.

In subsequent cases, however, the courts of Hong Kong, while ostensibly applying the *Hang Seng Bank* principle, seem to have been reverting to an approach resembling the operations test to determine the source of profit. Nevertheless, in *Macquarie Securities Limited v Commissioner of Inland Revenue* (2007) HKRC ¶90-195, the Court of Final Appeal criticised the Board of Review's reliance on the "brain analogy" (using the place of administration of the business as the criteria for ascertaining the geographical source of profits) and the "highly diffuse" approach to find out the "relevant factors in the determination of the territorial source" which in this case has resulted in the Board's wrong conclusion that the taxpayer had not discharged its burden of proof.

[¶6-1820] Apportionment of profits

It is inevitable that in certain cases profits arise, or are derived, from transactions conducted both in and outside Hong Kong. Traditionally, apportionment of profit was not regarded as possible. The Privy Council, however, has indicated that the absence of a specific legislative provision for apportionment does not remove the need or the possibility of profits being apportioned in certain circumstances, and the Inland Revenue has accepted that there are situations in which an apportionment of chargeable profits is appropriate.

The traditional approach

The Ordinance does not specifically provide for the apportionment of profits having more than one geographical source. Consequently, the traditional view has been that apportionment is not an option and that the dominant geographical source must be determined. Clough JA summarised the traditional approach during the Court of Appeal decision in *Commissioner of Inland Revenue v Hang Seng Bank Ltd* (1989) 1 HKRC ¶90-016 at p 100,210:

> "in a 'multi-source' situation, in the absence of provision for apportionment it is necessary to identify a dominant factor or factors which put the profits on one side of the line or the other."

See also *Commissioner of Inland Revenue v The Hong Kong & Whampoa Dock Co Ltd* (1960) 1 HKTC 85 and the judgment of Dixon J in *Commissioner of Taxation (NSW) v Hillsdon Watts Ltd* (1936) 57 CLR 36.

Possibility of apportionment introduced

Contrary to the traditional approach, the Privy Council in *Commissioner of Inland Revenue* v *Hang Seng Bank Limited* (1990) 1 HKRC ¶90-044 introduced the possibility of apportionment in cases where the gross profits arising from an individual transaction have arisen in or been derived from different locations. For example: where goods are sold outside Hong Kong but have been subject to manufacturing and finishing processes both

(*D55/00* IRBRD Vol 15)). However, the Inland Revenue Department does not consider that apportionment is required for trading profits. Requests to re-open previous years of assessment to permit apportionment will not be entertained which is in accordance with the prevailing practice under s 70A.

The Inland Revenue Department has set out several limitations on the apportionment of profits according to source. In contract processing cases, a 50:50 basis is applied as the norm and for other cases where apportionment is appropriate, the Inland Revenue Department will consider any rational basis put forward by the taxpayer. In addition, claims for general expenses which have contributed indirectly to the production of both Hong Kong and offshore profits must be scaled down. In most cases, it will be appropriate to apportion the general expenses by reference to gross profits (DIPN No 21 (Revised), para 47).

See ¶6-1940 for more details on "contract processing".

DETERMINING SOURCE OF SPECIFIC PROFITS

[¶6-1860] Guidance from Courts and Inland Revenue Department

After stating the broad guiding principle for determining source of profit in *Hang Seng Bank* (see ¶6-1740) the Privy Council offered guidelines on the factors that might be considered when determining the source of specific types of profits. The Privy Council did not aim to set down an exhaustive list of tests that must be applied to determine whether profits arose in or were derived from Hong Kong. The examples given simply provide guidance: see ¶6-1900, ¶6-1940, ¶6-2140 and ¶6-2180.

Taxpayers can also obtain guidance in respect of the source of profits by applying for an advance ruling from the Inland Revenue Department (see ¶13-0100ff).

Further guidance may be had from DIPN No 21 (Revised). That Practice Note sets out the Inland Revenue Department's views on the locality and subsequent taxability of various types of income or profit, including trading profits, manufacturing profits, commission income, and interest income. At the same time it repeatedly stresses that each case needs to be determined on its own facts.

The views and assessing practices of the Inland Revenue Department as set out in the Practice Note are not binding and do not affect a taxpayer's objection or appeal rights. Rather, they allow taxpayers and their advisers to know in advance where the Commissioner stands on the issue of profit source.

[¶6-1900] Trading profits

The Privy Council in *Hang Seng Bank* said that the determining factor for the source of trading profits is the place where the contracts for purchase and sale are "effected".

The word "effected" cannot simply mean legally executed according to the formal rules of contract offer and acceptance because the question of profit source is a hard, practical matter of fact. The Inland Revenue Department agrees with the approach in Magna and will contemplate all the relevant operations carried out to earn the profits, including the solicitation of orders, negotiation, conclusion, trade financing, shipment and performance of the contracts. The Department does not merely look at the place of contract to determine the geographical source of profits. (DIPN No 21 (Revised), para 21 and 22). The meaning of "effected" is likely to continue to be an area of controversy.

The Inland Revenue Department has set out its views on the source of profits from commodities or goods trading carried out by Hong Kong businesses. The Inland Revenue

Overseas sales network

In *Commissioner of Inland Revenue v Magna Industrial Company Limited* (1997) HKRC ¶90-082 the Court of Appeal ruled that the profits derived by the taxpayer from the sale of its products overseas, through a network of independent contractors, were not Hong Kong-sourced and therefore not assessable to profits tax. Overturning an earlier decision of the High Court, the Court of Appeal decided that the Board of Review was correct in the first instance in holding that the relevant profits did not arise in or derive from Hong Kong.

The taxpayer carried on a trading business in Hong Kong. Its products were sourced from overseas manufacturers and stored in Hong Kong by its independent wholly-owned subsidiary, A Ltd. Overseas sales of the products were made by a network of export managers appointed in the taxpayer's overseas sales regions. The export managers appointed distributors and sales were made when the export managers signed contracts, as the taxpayer's agents, with the distributors as purchasers. When orders were received, the taxpayer would purchase products from A Ltd and stock would be shipped from A Ltd's warehouse to the overseas distributors. The taxpayer received payments in Hong Kong, profits from which were assessed to profits tax by the Inland Revenue.

At the first stage of appeal, the Board of Review, looking at the totality of facts, found that the taxpayer's profits did not arise in Hong Kong from the trade or business carried on by the taxpayer in Hong Kong. The Board's view was that the taxpayer's case fell into the rare category of cases, referred to in the *HK-TVB* case, in which a taxpayer with a principal place of business in Hong Kong earns profits which are not chargeable to profits tax. Based upon the total facts the Board concluded that the sale of products through the network of overseas contractors was the most important factor and the source from which the taxpayer's profit arose. Although certain activities took place in Hong Kong, such as invoicing, shipping, collecting payment, etc, they were ancillary and not the true source of the profit (*Case* E63 (1995) 1 HKRC ¶80-360 (*D10/95* IRBRD Vol 10, 92)).

When the Commissioner appealed to the High Court, Jerome Chan J overturned the Board's decision and found that the taxpayer's profits were assessable in Hong Kong (*Commissioner of Inland Revenue v Magna Industrial Company Limited* (1996) HKRC ¶90-078). Chan J considered that A Ltd was a mere "puppet", that A Ltd's separate identity was artificial, and that all the activities involved in the purchase of the goods in Hong Kong should have been regarded as the taxpayer's activities. The taxpayer then appealed to the Court of Appeal.

Considering the activities as a whole which had a bearing on the question of the source of the taxpayer's profits, the Court of Appeal agreed that there were undoubtedly substantial activities taking place in Hong Kong, attributable to the taxpayer, without which the gross profits from the sales could not have been earned. However, the exceptional feature of the case was that the sales of the taxpayer's products were effected overseas by a network of independent contractors, resident in their own regions, who had authority to bind the taxpayer to specific orders from overseas distributors who, as far as the taxpayer was concerned, were the buyers.

In the Court's view, although the case may be regarded as falling within the extreme limits of the spectrum, the Board's conclusion that the relevant profits did not arise in or derive from Hong Kong was sustainable in law. It further added that Chan J was not entitled to find that A Ltd was a mere "puppet", and that its separate identity was "artificial", because that was never part of the Commissioner's case.

Activities performed by agent

The taxpayer in *Case* M64 (2003) HKRC ¶80-929 (*D20/02*) was a company incorporated in Hong Kong and carrying on a business of trading in raw materials and finished goods

needs of buyers and seller. This bringing together was done in Hong Kong so that the taxpayer's profits had clearly arisen from Hong Kong.

The *Euro Tech* decision coincides with the guidelines, as set out in DIPN No 21 (Revised), in accordance with which a business which performs only administrative functions may be assessed to tax if those functions include the acceptance or issuance of sale or purchase orders in or from Hong Kong. On the other hand, it may have limited application on the basis that the High Court's decision was inconsistent with the broad guiding principles of *Hang Seng Bank*. Barnett J, while purporting to apply those principles, actually applied a business operations test to determine the source of profits in the *Euro Tech* case, instead of having regard to the place where the contracts which gave rise the taxpayer's trading profits were actually effected.

In *Consco Trading Company Ltd* v *Commissioner of Inland Revenue* (2004) HKRC ¶90-132, the Board of Review's decision in *Case* M49 (2003) HKRC ¶80-914 (*D172/01* IRBRD Vol 17) to apply the "totality of facts" principle in determining the source of trading profits was upheld.

The taxpayer was engaged in the business of purchasing polysilicon rods, subcontracting the processing operations to a company in China and selling the finished products to customers in China and the United States. The taxpayer lodged an offshore claim on the basis that the solicitation, negotiation and conclusion of sales and purchase contracts were conducted outside Hong Kong by an agent with full authority and the activities carried out by the Hong Kong office, including arranging letters of credit, paying for raw materials and processing receipts from customers, were ancillary.

The Board of Review held that the trading profits in question arose in or were derived from Hong Kong and therefore, subject to Hong Kong profits tax. The Board took a global view in considering the taxpayer's overall operations and found that the opening of letters of credit was a crucial factor in determining the source of profits in this case.

The Court of First Instance concluded that the Board had applied correctly the totality of facts principle. The Board considered factors including the negotiation and conclusion of contracts, financing arrangements and accounting functions, and found that the financing arrangements and accounting functions were carried out in Hong Kong. The Court found that it was reasonable to conclude that the negotiations of contracts also took place in Hong Kong based on the evidence available.

Special administrative functions crucial to profit-making scheme

While the performance of *routine* administrative functions in Hong Kong may not be relevant for determining the source of a taxpayer's trading profits, the performance of *special* administrative functions which were crucial to the success of a profit-generating scheme was a decisive factor in *Case* D24 (1994) 1 HKRC ¶80-274 (*D47/93* IRBRD Vol 8). In that case the taxpayer, whose business was to facilitate the sale and purchase of products in the context of US anti-dumping laws, was assessable to profits tax on the profits earned from that business.

The taxpayer's role was to complete special summary invoices and special customs invoices addressed to the US Customs Department of the US Treasury. Since the performance of these administrative functions in Hong Kong was crucial to the success of the taxpayer's operations and the generation of the taxpayer's profits (which were received in a Hong Kong bank account) the Board found that the taxpayer's profits were sourced in Hong Kong and therefore assessable to tax (*HK-TVB* and *Hang Seng Bank* referred to).

- The Hong Kong company is responsible for the supply of raw materials and machinery and the provision of technical and managerial know-how without consideration.
- The Mainland processing enterprise is responsible for the provision of factory premises, utilities and labour force.
- The Hong Kong company pays a sub-contracting charge to the Mainland enterprise in return for the processing service.
- The legal title to the raw materials and finished goods remains with the Hong Kong company.

In such situations the strict legal position is that the Mainland processing unit is a sub-contractor separate and distinct from the Hong Kong manufacturing business and the question of apportionment should not arise. However, the Inland Revenue Department takes the view that the Hong Kong company's operations in Mainland China complement its operations in Hong Kong and recognising the operations of the Hong Kong company in the Mainland, an apportionment of profits on a 50:50 basis is usually accepted as a concession.

This approach will not apply, however, if the involvement of the Hong Kong business in the manufacturing process is minimal. The profits derived should be fully chargeable to profits tax and apportionment is not applicable (DIPN No 21 (Revised), para 37).

The taxpayer, in *Case* J55 (2000) HKRC ¶80-723 (*D145/99* IRBRD Vol 15), contended that it was engaged in the manufacturing of toys outside Hong Kong. The Board argued that the real nature of the taxpayer's business was the procurement of toys to satisfy sale and purchase contracts. The Board contended that it was the taxpayer's agent and not the taxpayer, which manufactured the toys. The agents purchased the raw materials and carried them to the processing plant to be turned into finished goods by the processing unit in China which were transported back to Hong Kong. Hence, the taxpayer did not manufacture the toys.

Import processing

Import processing involves the following:

- The manufacturing operations are carried out by a foreign investment enterprise (FIE) related to the Hong Kong company. An FIE is often a separate legal entity incorporated in the Mainland.
- The Hong Kong company sells raw materials to the FIE and buys back the finished goods from the FIE.
- The Hong Kong company engages in the trading of raw materials and finished goods whilst the FIE manufactures the finished goods.
- The legal title to the raw materials and the finished goods passes to/from the FIE.
- The gross profits arise from trading transactions where the Hong Kong company purchases finished goods from an FIE and sells them for a profit.
- The manufacturing operations of the FIE in the Mainland are not performed on behalf of, or for the account of, the Hong Kong company.

Case Q2 (2007) HKRC ¶81-188 (*D36/06* IRBRD Vol 21) was a typical import processing case and the Board held that the taxpayer's profits were fully chargeable to profits tax. For cases involving import processing, the Department holds the view that profits which accrued to the Hong Kong company from "trading transactions" carried out in Hong Kong cannot be attributed to the manufacturing operations of the FIE carrying on business in

Under the double taxation relief agreement concluded with the United States, gross income derived from the international operation of ships by residents of Hong Kong is exempt from income tax in the United States and international ship operators resident in the United States are exempt from Hong Kong profits tax. Under the double taxation relief agreements concluded with the United Kingdom of Great Britain and Northern Ireland, The Netherlands, Norway, Germany, Singapore, Sri Lanka, Luxembourg, Denmark and Belgium, generally income or profits derived from the international operation of ships by one country/territory, which are subject to tax in that country/territory, are exempted from income tax in the other country/territory. The types of taxes covered are specified in the agreements.

See ¶8-2000ff for further details on "Shipping income — Tax Relief Arrangement with Various Countries".

In addition to the shipping income agreements, Hong Kong has entered into various comprehensive double taxation agreements which provide similar double tax relief for profits from operations of ships in international traffic. See ¶8-5000 for the list of comprehensive double taxation agreements concluded by Hong Kong.

AIRCRAFT OWNERS

[¶6-7860] Assessable aircraft owners

Separate provisions for the assessment of aircraft owners took effect from the 1992/93 year of assessment. Previously, aircraft owners were assessed under the same provisions as ship owners. The provisions for the assessment of aircraft owners remain substantially similar to those which apply to ship owners (see ¶6-7620ff). However, there is no tax exemption for international aircraft profits as there is for the international shipping profits of Hong Kong registered ships (see ¶6-5700).

Resident aircraft owners

A person who carries on business as an owner of aircraft is deemed to be carrying on business in Hong Kong, if the business is normally controlled or managed in Hong Kong or if the person is a company incorporated in Hong Kong (s 23C(1)).

A person carries on "business as an owner of aircraft" when he or she is in the business of chartering or operating aircraft, which includes helicopters. The "operation" of aircraft for the purposes of the Ordinance includes the use or possession of the aircraft. Carrying on "business as an owner of aircraft" does not include dealing in aircraft or agency business connected with air transport (s 23C(5)).

The Ordinance does not define when a business is controlled or managed in Hong Kong. In practice, however, this will be satisfied if the control or management of the day-to-day business operations takes place in Hong Kong.

Non-resident aircraft owners

When an aircraft owned by a non-resident aircraft owner lands at any aerodrome or airport within Hong Kong the aircraft owner (or charterer) is deemed to have been carrying on business in Hong Kong and will be assessed to tax on its Hong Kong profits (s 23D(1)).

A non-resident aircraft owner is a person to whom s 23C (see above) does not apply. That is, a person carrying on a business as an owner of aircraft whose business is not normally controlled or managed from within Hong Kong; and who is *not* a company incorporated in Hong Kong.

It is not only payments specifically received in return for the shipment of passengers or goods that make up an aircraft owner's income. Payments "derived from, attributable to or in respect of" shipment are included in the calculation. A government grant supplementing an owner's income may, for example, qualify as income (see *Commissioner of Inland Revenue v Zim Israel Navigation Company Ltd* (1972) 1 HKTC 573).

Excluded from a taxpayer's Hong Kong aircraft income are payments received for:

(i) the carriage of "goods in transit", ie goods specified in an air way bill or post office delivery bill which are brought to Hong Kong by air solely for the purpose of onward carriage and for which freight charges are not paid or payable in Hong Kong; and

(ii) the carriage of "passengers in transit", ie passengers whose tickets do not specify Hong Kong as their destination or place of departure, or who fly in and out of Hong Kong within a 24-hour period in aircraft owned by the aircraft owner.

"Shipped in Hong Kong"

Passengers, mail, livestock and/or other goods are regarded as having been "shipped in Hong Kong" if they embarked or were shipped aboard an aircraft at any aerodrome or airport within Hong Kong. A receipt for carriage is only regarded as a Hong Kong receipt if the carriage commenced in Hong Kong. If a passenger boards an aircraft in Hong Kong and subsequently boards another aircraft to complete his or her travels, only the amount received by the aircraft owner for the first stage of the journey is regarded as Hong Kong aircraft income.

"Charter hire"

Sums earned by or accrued to an aircraft owner under a charter party by demise for the operation of aircraft are regarded as "charter hire". The term "demise" is not defined in the Ordinance. Normally, however, a demise will have occurred when the charterer controls the aircraft and the aircraft's captain is the charterer's servant.

When sums are earned under a non-demise charter party (ie a flight charter or a time charter) they are deemed to have been derived from the carriage of goods or passengers to the extent that they relate to flights commencing in Hong Kong:

- Any sum earned from a flight charter for a flight, or flights, commencing within Hong Kong constitutes Hong Kong aircraft income (s 23C(4)(a)).
- A proportion of the sum earned from a time charter constitutes Hong Kong aircraft income. The proportion which is Hong Kong income is equal to the proportion of the total flying hours of the relevant aircraft on outward flights from Hong Kong compared to the total number of the aircraft's flying hours under the time charter party (s 23C(4)(b)).

Amounts earned or accrued under a charter party which does not extend to a whole aircraft are excluded from the definition of "charter hire". They are, nevertheless, included in the aircraft owner's Hong Kong aircraft income as carriage receipts to the extent that they are derived from outward flights of the relevant aircraft from Hong Kong (s 23C(3)).

"Charter hire attributable to permanent establishment"

Charter hire attributable to a "permanent establishment" maintained outside Hong Kong is excluded from a resident aircraft owner's Hong Kong aircraft income. Charter hire attributable to a "permanent establishment" maintained in Hong Kong is included in the Hong Kong aircraft income of non-resident aircraft owners.

A "permanent establishment" is defined as a branch, management or other place of business. An agency is not regarded as a permanent establishment unless it regularly exercises a general authority to negotiate and conclude contracts on behalf of the principal (s 23C(5)).

X Aircraft Limited's assessable aircraft profits would be calculated as follows:

HK aircraft income	=	$10,000,000	(carriage receipts for passengers embarking in HK)
		$10,000,000	(charter hire, not attributable to permanent establishment outside HK, for flights in HK)
		$5,000,000	(50% carriage receipts between HK and Macau)
	+	$750,000	(proportion of time charter receipts equal to proportion of helicopter flight time flown under time charters)
		$25,750,000	
Total aircraft income	=	$15,000,000	(Total passenger carriage receipts)
	+	$26,000,000	(Total charter hire)
		$41,000,000	
Total aircraft profits	=	$41,000,000	(Total aircraft income)
	−	($4,000,000)	(Allowable deductions)
		$37,000,000	
Assessable aircraft profits	=	HK aircraft income / Total aircraft income	× Total aircraft profits
	=	$25,750,000 / $41,000,000	× 37,000,000
	=	$23,237,804	

Any other income accruing to the taxpayer is assessed according to the normal profits tax assessment rules. The assessable profit so determined is added to the assessable aircraft profits calculated above. The aircraft owner's tax liability can then be calculated.

[¶6-7980] Double tax relief arrangements

Hong Kong has entered into air services agreements with various countries/territories. A number of these agreements include specific provisions to prevent the double taxation of international air traffic income.

Under the air services agreements concluded with Canada, Korea, New Zealand, the Netherlands, Germany, the United Kingdom, Belgium, Denmark, Norway, Sweden, Bangladesh, Croatia, Estonia, Mauritius, Israel, Singapore, Sri Lanka, Mexico, Finland, Iceland, Jordan, Kenya and Kuwait, income or profits which are derived from the operation of aircraft in international traffic by an airline of one country/territory, and which are subject to tax in that country/territory, are exempted from income tax, profits tax and all other taxes on revenues, receipts, income or profits in the other country/territory on a reciprocal basis.

For further details on "Aircraft income — tax relief arrangements with various countries", see ¶8-3500.

For further details on "Aircraft income — tax relief arrangements with various countries", see ¶8-3500.

In addition to the air services agreements, Hong Kong has entered into various comprehensive double taxation agreements which provide similar double tax relief for

both sec 24 and 25 fell within Pt IV of the *Inland Revenue Ordinance* and sec 24 deemed that the Club was not carrying on a business, it must follow that the Club did not come within the scope of sec 25. Section 25 was intended to provide relief from double taxation, ie when property tax was payable, the amount paid could be used to reduce any profits tax payable. However, where no profits tax was payable as in the present case, it should again follow that the section could have no application.

"Club or similar institution"

The phrase "club or similar institution" is not defined in the Ordinance. It is accepted, however, that a club is an association formed for other than business purposes. Any association which has as its primary object the financial benefit of its members is not a "club or similar institution" (*Kowloon Stock Exchange Ltd v IRC* (1984) STC 602).

In the *Kowloon Stock Exchange* case it was held that the Kowloon Stock Exchange Limited could not be described as a club since it existed to aid the profit-making activities of its members. The Privy Council said that no distinction should be drawn between a mutual association which makes profits for itself and one which assists members to make profits for themselves.

A credit union was found to be a "club or similar institution" in *D1/79* IRBRD Vol 1, 328. The Board of Review in that case rejected the Deputy Commissioner's argument that the association could not be a club because it was concerned with making gains for its members. Considering the later Privy Council judgment in the *Kowloon Stock Exchange case*, a different conclusion may be reached today in a similar case.

[¶6-8060] Club members

The term "members" is defined to mean those persons entitled to vote at a general meeting of the club or similar institution (s 24(3)). Since it is common for clubs to have different classes of membership, including classes with no voting rights (eg visiting members), this definition is significant. A club which receives over half of its revenue from its members can still be caught by s 24(1) if less than half of that revenue comes from voting members. This problem can be avoided by giving out differential voting rights so that all members have voting rights but some have more than others.

[¶6-8100] Club receipts

The phrase "gross receipts on revenue account" is wide enough to include all receipts which are not of a capital nature. In practice, however, the Inland Revenue Department does not include non-business receipts such as donations. Entrance fees are specifically included in a club's income account even though many clubs include entrance fees in a capital account or reserve fund for accounting purposes.

TRADE, PROFESSIONAL OR BUSINESS ASSOCIATIONS

[¶6-8140] Trade, professional or business associations

A taxpayer who carries on a trade, professional or business association is deemed to be carrying on a business if more than half of its subscriptions are from persons who are entitled to claim them as allowable deductions under s 16 of the Ordinance (see ¶6-4600) (s 24(2)). When a taxpayer is deemed to be carrying on a business under s 24(2), the whole income of the association (including entrance fees and subscriptions) is deemed to constitute business receipts assessable to profits tax under s 14.

and so could not be assessed to tax on the non-resident's behalf. The only alternative was direct assessment.

To overcome the limitations imposed by the interpretation of "agent" in the Asia Television case, a new provision was introduced to the Ordinance which provides for the taxation of a non-resident in the name of any person who pays or credits him or her with payments in Hong Kong (DIPN No 17 (Revised), para 4–6) — this is discussed at ¶6-8380.

Duty of agent to report and make payment

When an agent sells goods on behalf of a non-resident person he or she must furnish quarterly returns to the Commissioner showing the gross proceeds from the sales (s 20A(3)). The agent is also required to pay 1% of the sale proceeds to the Commissioner. A lesser sum may be paid if the Commissioner agrees.

Duty of agent to withhold tax

From the assets which come into his or her possession or control on behalf of the principal, an agent must retain an amount which is sufficient to meet the tax liability of the principal (s 20A(2)). An agent is indemnified against any person in respect of the retention of the non-resident's assets.

Recovery of tax

Profits tax charged on a non-resident in the name of an agent is recoverable by all means provided in the Ordinance (see further ¶10-6200ff). It may be recovered from the assets of the non-resident or from the non-resident's agent (s 20A). If there is more than one agent they will be jointly or severally liable. As the Commissioner has the right of recourse against the assets of the agent (*CIR v Pacific Marine (HK) Ltd* (1964) DCLR 284), the agent has a duty to his or her own financial position, in addition to a statutory duty, to retain enough of the non-resident's assets to cover the tax payment.

Persons not treated as agents

Certain brokers and approved investment advisers are excluded from profits tax liability as agents in respect of securities trading and investment profits derived by non-resident investors for whom they act (s 20AA).

For more on "Brokers, investment advisers not treated as agents", see ¶6-8340.

[¶6-8340] Brokers, investment advisers not treated as agents

Stock brokers and approved investment advisers may be excluded from potential profits tax liability in respect of profits derived by non-resident investors for whom they act as agents. Provision is made under s 20AA of the Ordinance for qualifying brokers and investment advisers not to be treated as agents for tax purposes in respect of profits arising from their activities.

For the purpose of s 20AA, the terms "approved investment adviser" and "broker" are defined by reference to:

(i) the *Securities Ordinance* before its repeal for the years of assessment up to and including 2002/03. The basic position was that a person would qualify if registered as either a dealer, an exempt dealer, an investment adviser or an exempt investment adviser in the *Securities Ordinance*;

(ii) the *Securities and Futures Ordinance* (Cap 571) for the years of assessment commencing on or after 1 April 2003. A corporation licensed under s 116 and 117 of the *Securities and Futures Ordinance* (Cap 571) or an authorised financial institution registered under s 119 of the *Securities and Futures Ordinance* (Cap 571) to carry

This requirement would not be satisfied during the year of assessment under consideration if, apart from acting as a broker or an approved investment adviser, the person concerned also acted as an agent of the non-resident in some other capacity through which the non-resident derived chargeable profits.

However, the non-resident may derive chargeable profits through other agents in Hong Kong without it affecting the application of s 20AA in respect of the broker or approved investment adviser (DIPN No 30 (Revised), para 10(d), 12(d)).

Where the relevant activities constitute only part of a business, s 20AA is only applicable to that part as a separate business. It follows that s 20AA would not be applicable to activities performed by an agent for the non-resident in some capacity other than as a broker or an approved investment adviser (DIPN No 30 (Revised), para 14).

(v) The broker or approved investment adviser must not have been an "associate" of the non-resident person (see below) and, in the case of an approved investment adviser, must have been acting in an "independent capacity" (see below) (s 20AA(2) and (3)).

Where a transaction is carried out through a Hong Kong broker or an approved investment adviser at the request of a non-resident who is an associate of the broker or investment adviser, it does not necessarily follow that s 20AA cannot apply to the broker or investment adviser in respect of the transaction. Section 20AA will still apply if the non-resident associate is, in turn, acting as an agent in respect of the transaction for another non-resident who is not an associate of the Hong Kong broker or investment adviser. In other words, the Department will apply the associate test in respect of the relationship of the Hong Kong broker or investment adviser to the non-resident person (principal) who derived the profits in question.

In cases where an overseas associate of a broker or an investment adviser amalgamates orders from individual clients and passes them on as a single order (eg, through an omnibus account) to the Hong Kong broker or investment adviser, transactions for principals who are associated parties of the broker or investment adviser should be identified and excluded (DIPN No 30 (Revised), para 10(e), 12(e)).

Qualifying as broker or approved investment advisor

To qualify, a broker must be licensed to carry on a business in dealing in securities under Pt V of the *Securities and Futures Ordinance* (Cap 571). An investment adviser must be licensed to carry on a business in advising on securities on asset management under Pt V of that Ordinance.

Investment adviser acting in independent capacity

An investment adviser is regarded as acting in an independent capacity if the relationship between the adviser and the non-resident person appears to be a relationship between persons carrying on independent businesses dealing with each other at arm's length. The legal, financial and commercial characteristics of the relationship must be taken into consideration (s 20AA(5)).

However, s 20AA(5) does not provide that an adviser is to be necessarily recognised as acting in an independent capacity where the specified characteristics point to such an arm's length relationship. Other factors may be present which indicate to the contrary, though such a situation would presumably be unusual.

Therefore, in a situation where the investment adviser can readily ascertain that there is a profits tax liability and make arrangements for the payment of the tax, the Department will not accept that the requirement specified in s 20AA(3)(g) is satisfied (DIPN No 30 (Revised), para 16).

When both a taxpayer company and its tax representatives failed to attend a scheduled appeal hearing, the Board of Review found that it had no alternative but to dismiss the appeal in *Case* B27 (1992) 1 HKRC ¶80-188 (*D77/91* IRBRD Vol 7, 50). According to the Board, as the taxpayer was a company the reason for not attending the hearing could not have been sickness. Also, no reasonable cause was known why an authorised representative of the taxpayer could not have appeared. Accordingly, the Board found that it did not have the power to postpone or adjourn the appeal under sec 68(2B). Further, it was said that as a Hong Kong incorporated company is permanently present in Hong Kong the Board had no power to hear the appeal in the taxpayer's absence under sec 68(2D) (this provision is discussed below). The only remaining alternative was to dismiss the appeal. Also see Board of Review case *D6/13* (IRBRD Vol 28, 226); *Case* R7 (2008) HKRC ¶81-225 (*D6/07*); *Case* Q26 (2007) HKRC ¶81-212 (*D75/06*); *Case* Q19 (2007) HKRC ¶81-205 (*D64/06*); *Case* N47 (2004) HKRC ¶81-023 (*D46/03*); *Case* N19 (2004) HKRC ¶80-995 (*D135/02*); *Case* L61 (2002) HKRC ¶80-862 (*D83/01*); *Case* I37 (1999) HKRC ¶80-606 (*D88/98*) and *Case* C26 (1993) 1 HKRC ¶80-235 (*D52/92* IRBRD Vol 8,41).

The failure of an individual taxpayer to attend a hearing due to an overseas business visit could not of itself (without further elaboration) constitute a "reasonable excuse" enabling the Board of Review to postpone its hearing under sec 68(2B) in *Case* D32 (1994) 1 HKRC ¶80-282 (*D58/93*).

When an appeal has been dismissed due to the taxpayer's absence, the taxpayer may ask for a review within 30 days. If the Board is satisfied that the absence was due to sickness or other reasonable cause it may set aside the order for dismissal and hear the appeal (s 68(2C)).

Hearing of appeal in taxpayer's absence

A taxpayer may apply for an appeal to proceed in his or her absence if he or she is either outside Hong Kong or is unlikely to be in Hong Kong within a period considered reasonable by the Board (s 68(2D)). The application must be made to the Clerk at least seven days before the hearing. If the application is accepted, the Board will hear the appeal and consider any written representations made by the taxpayer (s 68(2E)). A written affirmation given in lieu of attendance may, however, carry relatively little weight with the Board since it cannot be tested by cross-examination (*D3/88* IRBRD Vol 3, 133).

In *Case* M9 (2003) HKRC ¶80-874 (*D101/01*), the taxpayer informed the Commissioner by email that he could not attend the hearing before the Board of Review. The Board of Review dismissed the appeal accordingly under sec 68(2B). The Board of Review did not consider the email as an application in writing to the Clerk to the Board under sec 68(2D) for the hearing to proceed in his absence.

However, in *Case* J51 (2000) HKRC ¶80-719 (*D139/99*), the taxpayer submitted an application requesting the hearing be heard during his absence. The taxpayer failed to mention in his application that he would be outside Hong Kong on the date of hearing nor the time he would return to Hong Kong. In view of the taxpayer's failure to satisfy the two conditions imposed under sec 68(2D), the Board rejected his application and dismissed his appeal as there was no evidence that his absence was due to illness or other reasonable cause.

See *Case* T7 (2010) HKRC ¶81-276 (*D59/08*).

Application for adjournment

A taxpayer or his or her tax representatives may apply to the Clerk to the Board for an adjournment of a Board of Review hearing. Applications for adjournment should be made as soon as possible after a hearing date has been set. The Board of Review has warned that taxpayers and their representatives or counsel should not assume that an adjournment of a

errors proved (*D47/88* IRBRD Vol 3, 419). See also *Case* U19 (2011) HKRC ¶81-325 (*D38/10*) and *Case* N69 (2004) HKRC ¶81-045 (*D93/03*).

The taxpayer in *Case* M94 (2003) HKRC ¶80-959 (*D69/02*) alleged that the Commissioner had failed to or avoided going through the documents which had been submitted and kept by the Inland Revenue Department for more than eight years. The Board however held that the taxpayer could not have a legitimate expectation that the Revenue would plough through massive documentation, unaided, to anticipate what the tax representative might say shortly before the hearing of the appeal. The Board held that the taxpayer should have addressed her mind to proving to the Board's satisfaction on a balance of probabilities how and to what extent the assessments appealed against were incorrect or excessive.

The personal representative of a taxpayer who objects to or appeals against an assessment on the taxpayer's behalf is subject to the same onus of proof as the taxpayer would be. No authority supports the proposition that a lower standard of proof would be required or that assumptions are made in favour of a person acting as a taxpayer's representative (*D14/83* IRBRD Vol 2, 47).

Witnesses

The Board may summon any person to attend a hearing as a witness (s 68(6)). The witness may be examined under oath or otherwise, and may be allowed reasonable expenses for attending. The Board also has powers granted under s 4(d), (e), (f) and (g) of the *Commissions of Inquiry Ordinance* (Cap 86) (s 68(10); see further ¶11-1600). A taxpayer who fails to comply with the Board's request to attend a hearing commits an offence (see ¶12-0900). The taxpayer may then be liable to a fine and the Court may order the taxpayer to comply with the request within a specified time.

Evidence

The provisions of the *Evidence Ordinance* (Cap 8) relating to admissibility do not apply to the Board of Review. The Board is entitled to admit or reject any evidence, oral or documentary, which is adduced (s 68(7)). The Board, therefore, has greater freedom of action than a Court in ascertaining facts on which to reach a decision and is free to draw inferences and reach conclusions on the facts on the balance of probabilities (*D20/78* IRBRD Vol 1, 345; DIPN No 6 (Revised), para 46).

[¶11-4250] The Board's ruling

The Board acts as a judicial tribunal whose first duty is to ascertain the basic facts. Where facts are disputed by the parties, the Board must resolve the dispute judicially. Having ascertained the facts, the Board must then consider whether the facts bring the case within the relevant provisions of the Ordinance (DIPN No 6 (Revised), para 48).

After hearing an appeal the Board is entitled to confirm, reduce, increase or annul the assessment under appeal. Alternatively, a case may be remitted back to the Commissioner, together with the opinion of the Board, for appropriate amendment (s 68(8)).

A decision of the Board of Review may be appealed in the Court of First Instance (see ¶11-5250). In certain cases, approval may be given for an appeal to proceed directly to the Court of Appeal for adjudication (see ¶11-6250).

Power of Board of Review to correct clerical mistakes and other errors

The Board of Review is empowered to correct any clerical mistake in any decision of the Board made in relation to an appeal or other error in any decision of the Board arising from any accidental slip or omission.

is not endorsed by the Board the appeal must proceed to be heard (sec 68(1E)); and the provisions regarding the conduct of the hearing, appearances, notifications, evidence, rulings, costs, etc, described in the preceding paragraphs will apply.

Once a settlement is accepted and endorsed by the Board, any necessary adjustments must be made to the relevant tax assessments. The assessments are then regarded as final and conclusive as far as the amount of assessable income, profits or net assessable value is concerned (s 68(1C)). An assessor subsequently may make assessments or additional assessments only if they do not re-open matters which have been endorsed by the Board (s 68(1D)).

Directions on provision of documents and information

At the hearing of an appeal under s 66, the person presiding at the hearing of an appeal may give directions on the provision of documents and information for the hearing; such person may refuse to admit in evidence any document or information that is not provided in compliance with directions (s 68AA(1)). The presiding person must give notice in writing to the defaulting party if he / she decides to refuse to admit in evidence any document or information provided by a defaulting party. The defaulting party may apply to the presiding person for relief against the decision within 14 days after the notice is given to the party or within a longer period that the presiding person allows. After the determination of the application of relief, a written notice by the presiding person must be given to the defaulting party.

Privileges and immunities

A chairman, a deputy chairman or any other member of the panel mentioned in s 65(1), and the parties to hearing as well as other persons appearing before the Board of Review have the same privileges and immunities as the persons would have in civil proceedings in the Court of First Instance (s 68AAB).

Transfer of appeal

[¶11-5000] Transfer of appeal from Board to Court of First Instance

When a valid notice of appeal has been lodged with the Board of Review, either party may give written notice to the Board that he or she wishes to have the appeal transferred to the Court of First Instance (s 67(1)). When such notice is given, the notifying party must also notify the other party to the appeal within 21 days after the notice of appeal is received by the Clerk to the Board (s 67(2)(a)). The Board may extend this time limit on a case-by-case basis upon application in writing by the appellant or the Commissioner (s 67(2)(b)). A copy of the transfer notice must be sent to the Board at the same time.

If the other party consents to the transfer, he or she must notify both the Board and the first party. Upon receipt of the notification, the Clerk will transmit the notice of appeal to the Court of First Instance together with the documents supporting the appeal (s 67(3)). Once an appeal is transferred to the Court of First Instance, it may only be withdrawn with the Court's consent (s 67(6)).

An appeal is only transferred when both parties consent. Factors influencing the decision of whether to proceed before the Board or the Court of First Instance include the following:

- a Court of First Instance hearing is more formal than a Board hearing;
- a Court of First Instance hearing may be more expensive; and
- the Court of First Instance can award full costs.

on the part of the taxpayer to trigger the running of the one-month period. Bearing in mind the ordinary meaning of "communication" and the use of the words "date of the communication" in the context of s 69(1), the Board held that the words referred to the action of communicating. In this regard, the Board held that the one-month period in this case started to run when "the communication" reached the intended address.

[¶11-5500] Hearing and decision

Any judge of the Court of First Instance may hear an appeal from a Board of Review decision and determine the question of law arising from the case stated. The Court of First Instance may only determine questions of law or mixed fact and law (see further ¶11-5750).

The Court of First Instance may confirm, reduce, increase or annul the disputed assessment. Alternatively, the assessment may be remitted to the Board of Review together with the Court's opinion (s 69(5)). The Board must then revise the assessment in accordance with the Court's opinion. The Court has the power to make any order regarding costs which it thinks fit (s 69(6)).

When an assessment is remitted to the Board, it was held by the Court of Appeal in *Yau Wah Yau* v *Commissioner of Inland Revenue* (2006) HKRC ¶90-178 that the statutory provisions did not confer any general power to remit the case to the Board for hearing de novo. The jurisdiction of the Court under sec 69 was to hear and determine any question of law and the Court may confirm, reduce, increase or annul the assessment determined by the Board. The Court may remit the case to the Board with an opinion related to a question of law, but it had no power to remit for the Board to reconsider their findings on the facts.

The Court of First Instance in *HIT Finance Ltd & Another* v *Commissioner of Inland Revenue* (2007) HKRC ¶90-194 proposed the following guidelines in remitting a case to the Board of Review:

(i) whether to remit a case stated is a matter of discretion;

(ii) the power to remit must be in the context of the case which has been stated. That is because the appeal under sec 69(1) is an appeal as to law and apart from that power to have a case stated on a matter of law arising out of a decision, the decision of the Board is required to be final;

(iii) the Board may be asked whether there is evidence which they did not refer to in the case stated that supports a finding of fact which they have made;

(iv) although there is no bar to the Board hearing further evidence, it can only be directed to issues arising in the questions on the case stated and the answers given by the Court;

(v) the Court will not, except in exceptional circumstances, remit a matter for a hearing de novo.

[¶11-5750] Question of law or fact

Appeals may be made to the Court of First Instance only on questions of law, or mixed fact and law (see *Commissioner of Inland Revenue v Asia Securities International Ltd* (1991) 1 HKRC ¶90-052). The Board of Review's decision on the facts is final (see *Hong Kong Oxygen & Acetylene Co Ltd v Commissioner of Inland Revenue* (2001) HKRC ¶90-108). An appellant cannot invite the Court to second-guess the Board's findings (*Commissioner of Inland Revenue v Aspiration Land Investment Ltd* (1990) 1 HKRC ¶90-046). An appellant may argue, however, that the Board's decision did not follow from the finding (*Edward v Bairstow* (1956) AC 14). It is also a question of law whether the Board has properly found a fact or improperly refused to find a fact (*D30/87(A)* IRBRD Vol 3, 176).

In considering the case law relevant to the distinction between questions of law and fact, it is important to appreciate that there are two categories of facts. The first are "primary" or "evidentiary" facts and are provable by direct evidence. The second are "ultimate" facts or conclusions of fact and are inferences drawn from the primary or evidentiary facts. Thus, in considering whether a taxpayer was resident in a particular place, the date he or she arrived in that place and the length of time spent there would be primary or evidentiary facts provable by direct evidence. The question of whether he or she was resident in that place would then be an ultimate fact or conclusion of fact drawn from the primary or evidentiary facts that had been proved.

When the relevant principles of law have been correctly identified by the Board and the only question is the application of those principles to the facts, that is normally a question of fact even though the Court might have reached a different conclusion on the facts (*Federal Commissioner of Taxation v Brixius* 87 ATC 4963; *Federal Commissioner of Taxation v Veterinary Medical and Surgical Supplies Ltd* 88 ATC 4642). However, a question of law will arise if there was no evidence to support the conclusion of fact, or it is obvious from the transcript of the case that the law was misunderstood in some relevant particular (*Lombardo v Federal Commissioner of Taxation* 79 ATC 4542; *Hope v The Council of the City of Bathurst* 80 ATC 4386) or the conclusion arrived at was not one which was reasonably open on the facts (*Veterinary Medical and Surgical Supplies Ltd*).

A finding by the Board on a matter of fact cannot be reviewed by a Court on appeal unless the finding is vitiated by some error of law. That error of law must arise on the facts as found by the Board or it must be established that the error of law is one which vitiates the findings made or has led the Board to omit to make a finding it was bound to make by law (*Politis v Federal Commissioner of Taxation* 88 ATC 5029).

However, a question of law will arise if there was no evidence to support the conclusion of fact, or it is obvious from the transcript of the case that the law was misunderstood in some relevant particular (*Lombardo v Federal Commissioner of Taxation* 79 ATC 4542; *Hope* v *The Council of the City of Bathurst* 80 ATC 4386) or the conclusion arrived at was not one which was reasonably open on the facts (*Veterinary Medical and Surgical Supplies Ltd*).

Unless some restrictions are applied to the availability of the submission that there was no evidence to support the decision, it would be open to any aggrieved appellant to submit that there was no evidence. In the case of *Lombardo*, Bowen CJ said that a question of law would be involved in a decision of the former Board of Review where, in a submission of no evidence, "there was a real possibility of success".

In *Aust-Key Co Ltd* v *Commissioner of Inland Revenue* (2001) HKRC ¶90-109, the Court held that the Board was entitled to make its own findings of fact after having considered the evidence and it was under a duty to do so. In addition, after taken into consideration the findings submitted by both parties, the Board was not obliged to seek a third party professional opinion if it did not accept those findings at last. There is no question of law in these situations.

A finding by the Board on a matter of fact cannot be reviewed by a Court on appeal unless the finding is vitiated by some error of law. That error of law must arise on the facts as found by the Board or it must be established that the error of law is one which vitiates the findings made or has led the Board to omit to make a finding it was bound to make by law (*Politis* v *Federal Commissioner of Taxation* 88 ATC 5029).

In the case *Brand Dragon Ltd (in members' voluntary liquidation) and Harvest Island International Ltd (in members' voluntary liquidation)* v *Commissioner of Inland Revenue* (2002) HKRC ¶90-115, the taxpayers, Brand Dragon Limited ("Brand Dragon") and Harvest Island Limited ("Harvest Island"), were newly incorporated joint venture companies beneficially owned by Vincent Cheung ("VC") and Eric Cheung ("EC"). Brand

HONG KONG BEARER INSTRUMENTS

[¶14-2700] Hong Kong bearer instruments

Bearer instruments which are either issued in Hong Kong, or issued elsewhere by or on behalf of a body corporate or another body of persons formed or established in Hong Kong, are chargeable to stamp duty (First Schedule, Head 3). A "bearer instrument" is an instrument through the delivery of which any stock can be transferred. The term, however, does not include an instrument relating to stock which consists of a loan which is not expressed in Hong Kong currency, except to the extent that the loan is repayable in Hong Kong currency (s 2(1)).

The amount of stamp duty payable on Hong Kong bearer instruments is set down in the First Schedule of the Ordinance (see ¶14-4300).

For the time limit applicable to the stamping of Hong Kong bearer instruments, see ¶14-5190.

DUPLICATES AND COUNTERPARTS

[¶14-2900] Duplicates and counterparts

A duplicate or counterpart of an instrument chargeable with stamp duty is itself also chargeable (First Schedule, Head 4). A duplicate or counterpart may be duly stamped either:

- as an original instrument;
- with an endorsement on the duplicate or counterpart of an instrument to the effect that duty has been paid on the original instrument of which it is the duplicate or counterpart; or
- with an endorsement on a stamp certificate issued for the duplicate or counterpart to the effect that duty has been paid on the original instrument of which it is the duplicate or counterpart (s 8).

For the duty payable on duplicates and counterparts, see ¶14-4460. For the time limit for stamping a duplicate or counterpart, see ¶14-5190.

DUTY PAYABLE AND PERSONS LIABLE

[¶14-3100] Stamp duty payable and persons liable

The tables which appear in the following paragraphs are derived from the First Schedule of the Ordinance. They show the stamp duty payable on various instruments. The persons who are liable for that duty and the factors affecting the calculation of the duty payable on certain instruments in special circumstances are also set out.

Note that the stamp duty payable on any chargeable instrument, as prescribed in the First Schedule, may be remitted, wholly or in part, under s 52.

such an agreement (or agreements) for sale, the amount of duty payable on the conveyance is determined by the following factors:

- whether there is more than one agreement;
- whether the agreement or agreements have been stamped; and
- whether the property is conveyed to the purchasers named in the agreement.

Conveyance executed in conformity with chargeable agreement for sale

When a conveyance on sale of residential property has been executed in conformity with a chargeable agreement for sale (see ¶14-1080ff), which has been stamped in accordance with the Ordinance, the stamp duty payable on the conveyance is $100 (s 29D(2)(a)). The phrase "in conformity with" means that the conveyance on sale is in favour of exactly the same person/s named in the agreement for sale as the purchaser/s and the conveyance is of the whole or part of the immovable property which is the subject matter of the agreement for sale (s 29D(6)(c), Stamp Office Practice Note No 1, para 60).

A conveyance on sale is regarded as being made between the same parties as a previous agreement for sale only if:

(i) the names of both the vendor and the purchaser, or the vendors and the purchasers if there are multiple parties, are the same in both the conveyance and the agreement; and

(ii) where there is more than one purchaser, the property or interest to be acquired by each purchaser is the same in both the conveyance and the agreement (s 29A(3A)).

If the agreement has not been stamped, the conveyance on sale is chargeable with a stamp duty in the same amount as any other conveyance for the sale of immovable property under Head 1(1) of the First Schedule (see above) and the agreement for sale is chargeable with a stamp duty of $100 (s 29D(2)(b)).

To determine the time for stamping the conveyance, it is deemed to have been executed on the date that the agreement for sale was made.

Conveyance executed in conformity with two or more agreements

When a conveyance on sale of residential property is executed *in conformity* with two or more agreements for sale, and each of the agreements has been stamped under the Ordinance, the conveyance is chargeable with the stamp duty prescribed under Head 1(1) of the First Schedule less the total amount of stamp duty paid for the agreements (s 29D(3)(a)). Any penalty which has been paid cannot be set off against the duty payable on the conveyance on sale.

If any of the agreements for sale have not been stamped, the conveyance on sale will not be stamped by the Collector unless the stamp duty payable on the conveyance under Head 1(1) is paid together with any penalty imposed for late stamping (see further ¶14-5270) (s 29D(3)(b)). The amount of duty paid on the other agreements may be deducted from the amount payable.

If the conveyance is stamped before each of the agreements is stamped, any unstamped agreements are chargeable with a $100 stamp duty (s 29D(3)(c)). Any agreement which has been assessed, remains chargeable with the assessed duty.

Conveyance in favour of purchaser and another

When a conveyance on sale for residential property is executed in pursuance of a chargeable agreement for sale (see ¶14-1080), in favour of a person named as the purchaser in the relevant agreement for sale, but also in favour of a person not named as the purchaser, the stamp duty payable is adjusted accordingly. If the agreement for sale has been stamped, the

and the conveyance is in favour of persons named in the agreement, but the conveyance is not executed in complete conformity with the agreement (s 29D(6)).

Refund of stamp duty on cancellation of agreement

Stamp duty and penalty cease to be payable on agreement for sale of residential property if the agreement has been cancelled or otherwise not performed other than by reason of occurrence of a specified event. An application for refund must be made to the Collector within two years after the agreement has been cancelled or otherwise not performed (s 29C(5B)).

Refund of stamp duty under s 29DF of the Stamp Duty Ordinance

On 22 February 2013, the HKSAR Government proposed to adjust the *ad valorem* stamp duty rates by doubling the scale of duty in order to discourage activity in the property market. The adjustments are contained in the *Stamp Duty (Amendment) (No. 2) Ordinance 2014*, which was gazetted on 25 July 2014. The new *ad valorem* stamp duty applies to all properties acquired on or after 23 February 2013, either by an individual or a company, except for those residential properties acquired by a Hong Kong permanent resident who does not own any other residential property in Hong Kong at the time of acquisition. At the same time, s 29DF of the Stamp Duty Ordinance was introduced to allow partial refund of stamp duty on disposal of residential property in certain circumstances. In particular, if a taxpayer buys a new residential property before selling the old one, the taxpayer can apply for a refund of the increased stamp duty (i.e. the difference between the new rate and the old one under s 29DF of the Stamp Duty Ordinance) if the taxpayer sells the old residential property within a short period of time.

In *Ho Kwok Tai v Collector of Stamp Revenue* (2015) HKRC ¶90-266, a judicial review case has been brought out by a taxpayer concerning the application for partial refund of ad valorem stamp duty under s 29DF of the Stamp Duty Ordinance. Mr. Ho, who purchased a new flat, disposed of two old flats within six months of his purchase of the new flat.

The completion of the sale of two old flats of Mr. Ho took place on 15 August 2013 and 23 September 2013 respectively, and the completion of his purchase of the new flat took place on 7 October 2013. Mr. Ho believed that he would be entitled to a refund of the difference between the new rate and the old one under s 29DF of the Stamp Duty Ordinance and therefore applied a refund of the difference of $273,750 through his solicitors.

The Collector of Stamp Revenue rejected the application based on the ground that the Mr. Ho would only have been eligible for a refund if the property he has disposed of had been his only residential property. Since Mr. Ho had disposed of two of his old flats, the provision did not apply to him. Mr. Ho argues otherwise and submitted an application for judicial review.

The Court of First Instance held that s 29DF of the Stamp Duty Ordinance applied to the situation where the purchaser owned more than one original residential property and the Collector of Stamp Revenue should refund the stamp duty difference to Mr. Ho. Further to the court judgement, the Collector of Stamp Revenue has lodged an appeal against the judgement of Court of First Instance.

Followed by the appeal lodged against the judgement of the Court of First Instance HCAL 49/2015, on 31 October 2016, in *Ho Kwok Tai* v *Collector of Stamp Revenue* (2016) CACV 52/2016 HKRC ¶90-267, the Court of Appeal ruled that the "Original Property" in s29DF was not intended to refer to more than one property. In English, that expression was defined to mean "another residential property… of which the person was a beneficial owner on the date of that acquisition", and in Chinese, the expression "原物業 (original property)" was defined to mean

In order for a refund to be made, a claim must be lodged with the Collector no later than two years after the instrument of conveyance or transfer was made or executed.

Agreement for sale of immovable residential property (Head 1(1A))

[¶14-3500] Stamp duty payable

Amount or value of consideration	Duty payable
$1 – $2,000,000	$100
$2,000,001 – $2,351,760	$100 + (10% × (consideration − $2,000,000))
$2,351,761 – $3,000,000	1.5% × consideration
$3,000,001 – $3,290,320	$45,000 + (10% × (consideration − $3,000,000))
$3,290,321 – $4,000,000	2.25% × consideration
$4,000,001 – $4,428,570	$90,000 + (10% × (consideration − $4,000,000))
$4,428,571 – $6,000,000	3% × consideration
$6,000,001 – $6,720,000	$180,000 + (10% × (consideration − $6,000,000))
$6,720,001 – $20,000,000	3.75% × consideration
$20,000,001 – $21,739,120	$750,000 + (10% × (consideration − $20,000,000))
$21,739,121 and above	4.25% × consideration

The above rates only apply if the agreement instrument is certified (under s 29G) to the effect that the transaction agreed to, or effected, by the instrument does not form part of a larger transaction or series of transactions for which a greater amount of consideration is payable (First Schedule, Head 1(1A)). When an agreement instrument is not so certified, a stamp duty is payable at the maximum rate of 4.25% of the consideration.

The HKSAR Government made an announcement on 22 February 2013 and proposed to adjust the ad valorem stamp duty rates on transfer of immovable property. The implementing legislation has been passed under the Stamp duty (Amendment) (No.2) Ordinance 2014 which was gazette on 25 July 2014. The adjusted rates ranging from 1.5% to 8.5% are applied. The ordinance advanced the charging of ad valorem duty on non-residential property transactions from conveyance of sale to the agreement for sale (see ¶14-3720).

The consideration to which regard is had for stamp duty purposes is the total value of the agreed consideration for the conveyance plus the amount of any other consideration paid to any person in connection with the agreement for sale, excluding legal expenses. The Stamp Office has indicated that while incidental expenses (eg agency fees, name transfer fees, mortgage fees, photocopying charges and travelling expenses) could arguably be included in "other consideration", the Collector's practice is to exclude such payments. A confirmor fee, however, must be included. (Stamp Office Practice Note No 1, para 20.)

The Special Stamp Duty on residential property transactions will also apply to agreements for sale of immovable residential property (see ¶14-3700).

(Note that the stamp duty payable on agreements for the sale of immovable residential property is the same as that payable on conveyances on sale.)