BUTTERWORTHS HONG KONG

Inland Revenue
HANDBOOK

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Inland Revenue Handbook

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The commentary in this book states the law as at 1 July 2025.

her net assessable income and that of his or her spouse as reduced by such deductions as are under Part 4A allowable to them. *(Amended 31 of 1998 s. 7)*

(3) Notwithstanding subsections (1) and (2), the amount of salaries tax charged under this section for the year of assessment commencing on 1 April 2006 shall be reduced by an amount equivalent to—

(a) 50% of the amount of the tax as computed under subsection (1) read together with subsection (2); or

(b) $15,000,

whichever is the less. *(Added 10 of 2007 s. 3)*

(Replaced 43 of 1989 s. 8. Amended E.R. 1 of 2012)

[13.01] Enactment history

Section 13(2) was amended by the Inland Revenue (Amendment) Ordinance 1998.

Subsection (3) was added by virtue of the Revenue Ordinance 2007 to reduce the salaries tax and tax under personal assessment payable for the year of assessment 2006-2007, thus giving effect to some of the proposals in the 2007-2008 Budget.

[13.02] General Note

Section 13 describes in detail the manner of calculating or computing the salaries tax.

13A. Part 8AA applies

Part 8AA applies for the purposes of calculation of salaries tax.

(Added 27 of 2018 s. 12)

[13A.01] General note

Section 13A was added by virtue of the Inland Revenue (Amendment) (No. 6) Ordinance 2018 the main objectives of which were to codify the transfer pricing principles, implement certain measures under the Base Erosion and Profit Shifting (BEPS) package and align the provisions in the Inland Revenue Ordinance (Cap 112) with international tax requirements.

Part 4

Profits Tax

(Added 15 of 2020 s. 2)

Division 1—Charge of Profits Tax

14. Charge of profits tax

(1) Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part. *(Replaced 2 of 1971 s. 9. Amended 7 of 1986 s. 12; 56 of 1993 s. 8; 13 of 2018 s. 3)*

(2) For a person other than a corporation, the tax is to be charged on the assessable profits of the person—

(a) for any year of assessment commencing before 1 April 2018—at the standard rate; or

(b) for any year of assessment commencing on or after 1 April 2018—in accordance with section 2 of Schedule 8A. *(Replaced 13 of 2018 s. 3)*

(3) For a corporation, the tax is to be charged, subject to subsections (4) and (5), on the assessable profits of the corporation—

(a) for any year of assessment commencing before 1 April 2018—at the rate specified in Schedule 8; or

(b) for any year of assessment commencing on or after 1 April 2018—in accordance with section 2(a) of Schedule 8B. *(Added 13 of 2018 s. 3)*

(4) If a corporation is a partner in a partnership, in relation to any share of assessable profits of the partnership apportioned to the corporation under section 22A, the tax is to be charged—

(a) for any year of assessment commencing before 1 April 2018—at the rate specified in Schedule 8; or

(b) for any year of assessment commencing on or after 1 April 2018—in accordance with section 2(b) of Schedule 8B. *(Added 13 of 2018 s. 3)*

(5) If a corporation has made an election under section 14B(2)(b),

14D(5)(b), 14H(4)(b), 14J(5)(b), 14P(4)(b), 14T(5)(b), 14ZD(7)(b), 14ZM(7)(b) or 14ZV(7)(b) or section 4 of Schedule 17FD in respect of a portion of its assessable profits, then, in relation to the rest of its assessable profits, the tax is to be charged at the rate specified in Schedule 8. *(Added 13 of 2018 s. 3. Amended 9 of 2019 s. 3; 5 of 2020 s. 4; 10 of 2022 s. 3; 17 of 2024 s. 3)*

[14.01] Enactment history

Subsections (1) and (2) were amended and (3), (4) and (5) were added in 2018 (Ordinance No. 13 of 2018) to introduce two-tiered profits tax rates for corporations and unincorporated businesses with effect from the 2018/19 year of assessment. Schedules 8A and 8B were added at the same time to specify those rates.

Section 14(5) was amended in 2019 (Ordinance No. 9 of 2019) to correct a cross-reference.

Section 14(5) was amended in 2020 (Ordinance No. 5 of 2020) so that two-tiered profits tax rates would not be applicable to corporations making an election under section 14P(4)(b) (qualifying ship lessors) or 14T(5)(b) (qualifying ship leasing managers).

Section 14(5) was amended in 2022 (Ordinance No. 10 of 2022) so that two-tiered profits tax rates would not be applicable to corporations making an election under section 14ZD(7)(b) (qualifying ship agent), 14ZM(7)(b) (qualifying ship manager) or 14ZV(7)(b) (qualifying ship broker)).

[14.02] Profits tax rates

For any year of assessment commencing on or after 1 April 2018, profits tax is to be charged at the rates set out in Schedule 8A or 8B (according to whether the taxpayer is a corporation).

The two-tiered profits tax rates in Sch 8B are not applicable to corporations that have made an election under ss 14B(2)(b) (qualifying insurance business and insurance brokerage business), 14D(5)(b) (qualifying corporate treasury centre), 14H(4)(b) (qualifying aircraft lessors), 14J(5)(b) (qualifying aircraft leasing managers), 14P(4)(b) (qualifying ship lessors), 14T(5)(b) (qualifying ship leasing managers), 14ZD(7)(b) (qualifying ship agent), 14ZM(7)(b) (qualifying ship manager) or 14ZV(7)(b) (qualifying ship broker). For these corporations, Sch 8 applies.

[14.03] Structure of section 14(1)

In *CIR v Hang Seng Bank Ltd* [1991] 1 AC 306, [1990] 3 WLR 1120 (PC), the Privy Council held that three conditions must be satisfied before a charge to profits tax can arise under s 14: (1) the taxpayer must carry on a trade, profession or business in Hong Kong; (2) the profits to be charged must be 'from such trade,

profession or business'; (3) those profits must also be 'profits arising in or derived from Hong Kong'. Construing (2) and (3) as being different conditions, the Privy Council held that the Commissioner could not make profits taxable by showing only that the profits were earned by a business carried on in Hong Kong, as condition (3) would then be rendered otiose. In other words, the structure of s 14(1) presupposes that profits of a Hong Kong business may accrue from sources in and outside Hong Kong. Profits accruing from sources outside Hong Kong are not taxable, despite being they are earned 'from' or 'by' a Hong Kong business (see the Privy Council's wording in relation to condition (2)).

By the same token, profits accruing from a source in Hong Kong may not necessarily satisfy condition (2). For example, securities transactions in Hong Kong may bring profits to an overseas company that does not carry on any business in Hong Kong or whose Hong Kong branch business is not responsible for earning those profits.

Apart from the three main conditions above, the operation of s 14(1) is always '[s]ubject to the provision of this Ordinance'.

[14.04] Trade, profession or business

It has been said that the question whether something amounts to the carrying on of a trade or business is a question of fact and degree (see *Lee Yee Shing & Anor v CIR* [2008] 2 HKC 436, (2008) 11 HKCFAR 6, [2008] 3 HKLRD 51 (CFA) at para 38). However, this should be understood in light of Viscount Simonds' explanation in *Edwards v Bairstow & Anor* [1956] AC 14:

> 'When the Commissioners, having found the so-called primary facts ... proceed to their finding in the Supplemental Case that the transaction, the subject-matter of this Case, was not an 'adventure in the nature of trade', this is a finding which is in truth no more than an inference from the facts previously found. It could aptly be preceded by the word 'therefore'. Is it then an inference of fact? My Lords, it appears to me that the authority is overwhelming for saying that it is ... Yet it must be clear that to say that such an inference is one of fact postulates that the character of that which is inferred is a matter of fact. To say that a transaction is or is not an adventure in the nature of trade is to say that it has or has not the characteristics which distinguish such an adventure. But it is a question of law not of fact what are those characteristics, or, in other words, what the statutory language means. It follows that the inference can only be regarded as an inference of fact if it is assumed that the tribunal which makes it is rightly directed in law what the characteristics are and that, I think, is the assumption that is made. It is a question of law what is murder: a jury finding as a fact that murder has been committed has been directed on the law and acts under that direction. The Commissioners making an inference of fact that a transaction is or is not an adventure in the nature of trade are assumed to be similarly directed, and their finding thus becomes an inference of fact.

In *Eclipse Film Partners (No 35) LLP v HMRC* [2015] STC 1429 at [112], Sir Terence Etherton also explained:

As an ordinary word in the English language 'trade' has or has had a variety of meanings or shades of meaning. Its meaning in tax legislation is a matter of law. Whether or not a particular activity is a trade, within the meaning of the tax legislation, depends on the evaluation of the activity by the tribunal of fact. These propositions can be broken down into the following components. It is a matter of law whether some particular factor or characteristic is capable of being an indication of trading activity. It is a matter of law whether a particular activity is capable of constituting a trade. Whether or not the particular activity in question constitutes a trade depends upon an evaluation of all the facts relating to it against the background of the applicable legal principles. To that extent the conclusion is one of fact, or, more accurately, it is an inference of fact from the primary facts found by the a fact-finding tribunal.

Carrying on a business

In *Kirkwood v Gadd* [1910] AC 422, in the context of the Money-Lenders Act 1900, Lord Loreburn LC said: 'What is carrying on business? It imports a series or repetition of facts'.

'Business' is defined under s 2(1) to include (amongst other things) the letting or sub-letting by any corporation of any premises, and the sub-letting by any other person of any premises held under a lease or tenancy other than from the Government.

The carrying on of 'business' usually calls for some activity on the part of whoever carries it on, although, depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between: *American Leaf Blending Co Sdn Bhd v DGIR* [1979] AC 676 at 684. 'Business is not confined to being busy: in many businesses long intervals of inactivity occurred': *CIR v The South Behar Railway Co Ltd* 12 TC 657 at 712.

In the case of a company incorporated for the purpose of making profits for its shareholders, any gainful use to which it puts any of its assets *prima facie* amounts to the carrying on of a business: *American Leaf* (cited in *CIR v Bartica Investment Ltd* [1996] 4 HKC 599 (HC); *Newfair Holdings Ltd v CIR* [2022] HKCU 1749, [2022] HKCFI 1133; and *Touax Container Investment Ltd v the CIR* [2024] HKCU 3500, [2024] HKCFI 2242).

In *IRCs v Westleigh Estates Co.* 1 KB 390 (at 409) Pollock MR said: 'If [a company's] objects are business objects and are in fact carried out it ... carries on business'. The Privy Council in *American Leaf* (at 683) referred to Pollock MR's statement as one made in the context of a company carrying out one of its principal objects as stated in its memorandum. The Privy Council expressly declined to endorse any general proposition that every isolated act of a company – if authorised by the company's memorandum – necessarily constitutes the carrying on of a business.

In *South Behar*, Lord Sumner (at 710) held that to ascertain the business of a limited liability company, one must look to see what business objects are provided in its memorandum and whether those objects are being pursued. The taxpayer in that case held a railway which was operated by another company. The taxpayer was entitled to a share in the profits of the railway operation. Later, it relinquished

the possession of the railway and was then entitled to an annuity in lieu of the share of profits. Thereafter the taxpayer did nothing but receive annuity payments and distribute them to its shareholders. The House of Lords held that the taxpayer was carrying on a trade or business or undertaking of similar character and was therefore liable to corporation profits tax. Lord Sumner said (at 711):

> I do not attach much importance to the domestic operations of declaring and paying dividends, remunerating directors and presenting reports, but the operation of receiving and thus discharging the annuity payments goes on continuously, and however simple, it is not a mere passive acquiescence. It is the transaction of business between debtor and creditor resulting periodically in the discharge of a debt. The present is not the case of a company existing to do one act only and once for all. Not only did the Company make the agreement of 1906, but it plays its recurring part in every payment and receipt of gains, and there is here, therefore, that 'repetition of acts,' which Lord Justice Brett [in *Smith v Anderson*] says (15 Ch. D. at p.277) is implied in 'carrying on business.'

In the case of a private individual, the mere receipt of rents from property raises no presumption that the individual is carrying on a business (see *American Leaf* at 684). In relation to private individuals buying and selling shares, McHugh NPJ in *Lee Yee Shing* (at para 95) identified 26 factors that are relevant in determining whether an individual carries on a business. The presence of a number of these factors may indicate that the individual's activities are so considerable, organised and systematic that amount to a business of share dealing.

Business is a wider concept than trade: see *American Leaf* at 684; and *Rangatira Ltd v CIR* [1997] STC 47. Judicial recognition of this point can be traced as far back as the judgment of the Court of King's Bench in *Doe d Wetherell v. Bird* (1834) 2 Ad & E 161 where Lord Denman CJ said (at 166) that '[e]very trade is a business, but every business is not a trade' (see *Lee Yee Shing* at para 17).

Carrying on a trade

'Trade' is defined under s 2(1) to include 'every trade and manufacture, and every adventure and concern in the nature of trade'. In *Lee Yee Shing*, McHugh NPJ (at para 54) considered the definition to be 'of no practical assistance'.

However, no principle of case law defines 'trade'. In *Kowloon Stock Exchange Ltd v CIR* [1985] 2 HKC 461 (PC) (at 268), Lord Brightman described the term 'trade' without defining it:

> The word 'trade' is no doubt capable of bearing a variety of meanings according to the context in which it is used. In its most restricted sense it means the buying and selling of goods; in a slightly wider sense, it includes the buying and selling of land; there is no reason to exclude, in an appropriate context, the buying and selling of choses in action. It is commonly used '... to denote operations of a commercial character by which the trade provides to customers for reward some kind of goods or services': *Ransom v. Higgs* [1974] 1 WLR 1594 at 1600.

In determining whether certain activities amount to a trade, a tribunal of fact is required to make a value judgment after examining all the circumstances involved in the activities: *Lee Yee Shing*, per McHugh NPJ at para 54, citing Jessel MR in *Erichsen v Last* (1881) 8 QBD 414 at 416.

In *Simmons v IRCs* [1980] 2 All ER 798 (at 800), Lord Wilberforce said:

> Trading requires an intention to trade; normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necessary to ask further questions: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or a loss. Intentions may be changed. What was first an investment may be put into the trading stock, and, I suppose, vice versa.

The intention to trade to which Lord Wilberforce referred is not subjective but objective: *Iswera v CIR* [1965] 1 WLR 663 at 668; and *Lee Yee Shing* (at para 59).

In *Perfekta Enterprises Ltd v CIR* [2019] 4 HKC 383, (2019) 22 HKCFAR 201, [2019] HKCFA 25, the taxpayer maintained that it had no intention to trade the property it had owned as a long-term capital asset and that any intention to trade was that of its subsidiary, to which the taxpayer transferred the property. Allowing the taxpayer's appeal, the Court of Final Appeal emphasised that the subsidiary was a separate legal entity and 'the court is not free to disregard the principle of *Salomon v A Salomon & Co Ltd* [1897] AC 22', save in limited circumstances.

A tribunal of fact shall determine the question of intention by examining all the circumstances objectively to see whether or not the 'badges of trade' are present. In substance, the 'badges of trade' are the criteria for determining what Lord Wilberforce called 'an operation of trade': *Lee Yee Shing* (at para 59).

As McHugh NPJ articulated in *Lee Yee Shing* (at para 60), the 'badges of trade' are (for most cases) questions of whether the taxpayer:

(1) has frequently engaged in similar transactions?
(2) has held the asset or commodity for a lengthy period?
(3) has acquired an asset or commodity that is normally the subject of trading rather than investment?
(4) has bought large quantities or numbers of the commodity or asset?
(5) has sold the commodity or asset for reasons that would not exist if the taxpayer had an intention to resell at the time of acquisition?
(6) has sought to add re-sale value to the asset by additions or repair?
(7) has expended time, money or effort in selling the asset or commodity that goes beyond what might be expected of a non-trader seeking to sell an asset of that class?
(8) has conceded an actual intention to resell at a profit when the asset or commodity was acquired?
(9) has purchased the asset or commodity for personal use or pleasure or for income?

'Badges of trade' is a convenient expression to describe the various factors which might help a tribunal to decide whether there was trading or intention to trade. These factors are not to be applied mechanically since the relevance and importance of each may vary according to circumstances: *Church Body of the Hong Kong Sheng Kung Hui & Anor v Commissioner of Inland Revenue* [2017] 1 HKC 1, (2016) 19 HKCFAR 54 (CFA) at para 30, per Tang PJ. As said in *Marson v Morton* [1986] 1 WLR 1343 (per Browne-Wilkinson VC at 1348D), 'the most they can do is provide common sense guidance to the conclusion which is appropriate'. For further commentary on the 'badges of trade', see [14.10].

Traditionally, gambling is not seen as carrying on a trade: *Graham v Green* (1925) 9 TC 309 at 314.

In *Salt v Chamberlain* [1979] STC 750 at 760, the English High Court concluded that 'Where the question is whether an individual engaged in speculative dealings in securities is carrying on a trade, the prima facie presumption would be ... that he is not. It is for the fact-finding tribunal to say whether the circumstances proved in evidence or admitted take the case out of the norm'. In the Hong Kong context, see *CIR v Dr Chang Liang-Jen* (1977) 1 HKTC 975 (HC).

In *Lee Yee Shing*, McHugh NPJ noted (at para 63-65) that tax authorities and tribunals of fact have generally shown reluctance to find that the profits and losses of private individuals who buy and sell shares are within the tax regime, unlike cases where landed properties are bought with the intention of re-selling them at a profit. His Lordship explained (at para 65-66):

> The answer, I think, must be that, consciously or unconsciously, taxation authorities and tribunals see the buying of shares, other than for investment or as an incident in the carrying on of a business of share trading, as a gamble or akin to a gamble ... Hence, the taxation regime is attracted only when the taxpayer's course of share trading is so organised, systematic and habitual that it answers the description of 'carrying on a business' or is carried out by persons who own or are employed in or are closely associated with enterprises that are involved in share trading or broking or similar enterprises.

Perhaps another answer lies in the need for capital preservation as share prices are relatively more volatile. As Lord Wilberforce recognised in *Simmons* (at 800), 'permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade'. The relative ease with which shares can be bought and sold facilitates the switching of investments in order to preserve capital. This is in clear contrast with the relatively more stable real estate market and the formality involved in landed property transactions.

The switching of share investments, even if done over a short period, does not necessarily invite the view that there is an operation of trade. On the other hand, if a private individual goes to the trouble of purchasing and reselling a landed property over a short period, this will more readily be seen by tribunals of fact as pointing to an operation of trade.

Carrying on a profession

As to what constitutes a profession, the basic test was laid down by Du Parcq LJ in *Carr v IRCs* (1944) 2 All ER 163 at 166:

> Ultimately one has to answer this question: Would the ordinary man, the ordinary reasonable man – the man, if you like to refer to an old friend, on the Clapham omnibus – say now, in the time in which we live, of any particular occupation, that it is properly described as a profession? ... It must be the intention of the legislature, when it refers to a profession, to indicate what the ordinary intelligent subject, taking down the volume of the statutes and reading the section, will think that 'profession' means. I do not think that the lawyer as such can help him very much.

Thus, Du Parcq LJ made it clear that the categories of profession are not closed. One should consider modern-day circumstances when considering whether or not an occupation is a profession.

[14.05] Trade, profession or business 'in Hong Kong'

The commentary below concerns the location of a trade, profession or business. As to what constitutes a trade, profession or business, see [14.04].

Whether a business is carried on in a particular place is a question of fact: *CIR v Bartica Investment Ltd* [1996] 4 HKC 599 (HC) at 613F.

In *Bartica*, the taxpayer was incorporated in Hong Kong as a shelf company. It was acquired by members of a family living in Australia, for the purpose of carrying out a business scheme of the family in order to achieve an Australian tax benefit. The taxpayer's shareholders, directors and secretary were all nominee companies incorporated in Hong Kong which were owned and managed by Price Waterhouse, an accounting firm. The nominee companies held the taxpayer's shares on trust for the family in Australia. On a back-to-back basis, the family's scheme involved the taxpayer placing deposits with banks and pledging the same as securities for loans advanced by those banks to an Australian hotel company beneficially owned by the family. The taxpayer received funding for the deposits in the form of interest-free shareholder loans from Australia. Interest arose out of the deposits and most of the interest earned by the taxpayer was used by the family to offset interest which was paid by the hotel company in Australia. These activities were carried out over a period of about 5 years.

It was held (at 612A–B) that the taxpayer's holding of deposits, whether considered on its own or in connection with the giving of securities, did constitute the carrying on of a business. The Court went on to hold (at 614A–F):

> ... once it is concluded that there was business, the evidence clearly showed that the business activities were carried out in Hong Kong. In respect of Westpac Bank, all the deposits were placed and rolled over in Hong Kong. It was against the deposits that a first mortgage was created in favour of Westpac Bank. In respect of the Citibank, for two years the deposits were in Singapore. However, the funds were transferred from the taxpayer's account in Westpac Bank Hong Kong to Singapore. From August and September 1986 onwards, the deposits in Citibank were transferred from Singapore to their Hong Kong office. The interest income on the deposits were received by the taxpayer in Hong Kong. In *Werle & Co.* [2 TC 402], Esher M. held that: 'If the profits are received in England, that is a very strong circumstance. If there is an establishment in England, that is a very strong circumstance; but neither of them is essential. One must come to see what is the truth ...'
>
> The taxpayer kept all of its accounting and other records in Hong Kong. They were maintained by Price Waterhouse. Board meetings of the nominee directors took place in Hong Kong by way of paper meetings. Certainly, as far as Westpac Bank was concerned, although instructions were given to and accepted by the bank from the family members, the legal authorised signatories of the taxpayer were the nominees of Price Waterhouse who were required to confirm the instructions. This is a case where the true and the only reasonable conclusion contradicts the determination of the Board. All the facts point towards the business being carried on in Hong Kong.

In the court's view (at 613I), the fact that members of the family had made business decisions and conducted negotiations for the taxpayer could not be the only basis for one to conclude that the taxpayer's business did not take place in Hong Kong. The court held (at 613H) that the principle in *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455, 5 TC 198 could not be the guiding principle, as that case concerned the place of residence of a corporation for tax purposes.

Bartica was distinguished on the facts in *Newfair Holdings Ltd v CIR* [2022] HKCU 1749, [2022] HKCFI 1133, where the taxpayer's sales revenue was generated from merchandise contracts. The Court of First Instance held that the receipt of the revenue in Hong Kong was not the activity generating the revenue. The activity of paying the suppliers in Hong Kong was an administrative act after the profit-generating contracts were entered into. Neither activity was considered by the court as amounting to a business 'in Hong Kong'. In both *Touax Container Investment Ltd v the CIR* [2024] HKCU 3500, [2024] HKCFI 2242 and *Patrick Cox Asia Ltd v CIR* [2024] 1 HKC 262, [2023] HKCFI 2676, the Court of First Instance noted that *Newfair* was decided on its own particular facts. But so too were the court's decisions in *Touax* and *Patrick Cox*.

As in the case of a business, the question of where a trade is exercised is a question of fact: *Werle & Co v Colquhoun* (1888) 20 QBD 753, (1888) 2 TC 402, per Esher MR at 408 (TC). Whilst this is true in a sense, it is essential to identify the elements which constitute the exercise of a trade within the meaning of the taxing statute: *Grainger & Son v Gough* [1896] AC 325, per Lord Herschell at 335.

In *Erichsen v Last* (1881) 8 QBD 414, one of the questions for the English Court of Appeal was whether the appellants, a company domiciled in Copenhagen, exercised any trade within the United Kingdom. Brett LJ said (at 418):

> ... wherever profitable contracts are habitually made in England, by or for foreigners, with persons in England, because they are in England, to do something for or supply something to those persons, such foreigners are exercising a profitable trade in England, even though everything to be done by them in order to fulfil the contracts is done abroad.

In *Grainger & Son v Gough* [1896] AC 325, the appellants acted as agents for a wine merchant in France called M. Louis Roederer. All that the agents did in the United Kingdom on Roederer's behalf was to canvass for orders, transmit those orders to France and in some cases, receive payment from customers. In receiving an order the agents did not accept or purport to accept it on Roederer's behalf. No contract to sell wine was ever made by the agents on behalf of the French merchant. The wine was sold as it lied in the cellar in France. The customer paid the cost of packing and carriage from the cellar and took all risk. The delivery, therefore, took place in France.

Drawing a broad distinction between trading *with* a country and trading within a country, the House of Lords held that the French merchant did not exercise a trade in the United Kingdom. Lord Herschell said (at 336):

> If all that a merchant does in any particular country is to solicit orders, I do not think he can reasonably be said to exercise or carry on his trade in that country. What is done there is only ancillary to the exercise of his trade in the country where he buys or makes, stores, and sells his goods.

This was despite the commercial importance of those ancillary activities, as Lord Watson said (at 340–341):

> There may, in my opinion, be transactions by or on behalf of a foreign merchant in this country so intimately connected with his business abroad that without them it could not be successfully carried on, which are nevertheless insufficient to constitute an exercise of his trade here ...

In *Sulley v AG* 2 TC 149, Sulley was a partner in a firm of general merchants and drapers, which carried on business in the US and the UK. He resided in the UK and all the other partners in New York. He transacted the business of the firm in England, which consisted of purchasing and shipping goods for exportation. The profits of the firm were made by re-sale of the goods in the US. The Court of Exchequer held that the firm's trade was not carried on or exercised in the UK despite the purchasing and shipping of goods in the UK.

In view of *Grainger* and other cases indicating that it was sufficient to consider only the place where sale contracts were made, Atkin LJ in *Smidth v Greenwood* 8 TC 193 (at 203–204) said:

> But I am not prepared to hold that this test is decisive. I can imagine cases where the contract of re-sale is made abroad, and yet the manufacture of the goods, some negotiation of the terms, and complete execution of the contract take place here under such circumstances that the trade was in truth exercised here. I think that the question is, where do the operations take place from which the profits in substance arose?

As to whether a trade or business carried on abroad could be attributed to the taxpayer's management and control in the United Kingdom, see the House of Lords' decisions in *San Paulo (Brazilian) Ry Co v Carter* [1896] AC 31 and *Mitchell v Egyptian Hotels Ltd* [1915] AC 1022. In the latter case, it was argued for the Crown that a company can only have one business and that such business necessarily includes the passing of annual accounts, the declaration of dividends and the financial arrangements necessary to enable such dividends to be paid. Lord Parker rejected the argument in these terms (at 1038–1039):

> The trade or business we have to consider is a trade or business from which profits or gains can arise and not the business of disposing of and dividing such profits and gains when they have arisen, and I can see no reason why a corporation any less than an individual should not be engaged in more than one trade or business at the same time.

A non-resident person who has a 'permanent establishment' ('PE') in Hong Kong is regarded, under s 50AAK(1), as carrying on a trade, profession or business in Hong Kong for the purposes of charging profits tax. Section 50AAK(1) applies '[w]ithout limiting section 14'. It does not go so far as to say that a non-resident person who has no PE in Hong Kong will not be regarded as carrying on a business in Hong Kong. Thus, a non-resident person may still come within the scope of s 14(1) under ordinary concepts, even in the absence of a PE in Hong Kong. This is subject to any application provision of a Double Taxation Agreement (see Pt 8).

[14.06] Profits 'from such trade, profession or business'

The commentary below concerns the connection required by s 14(1) between the trade, profession or business that a person carries on in Hong Kong and the profits of that person. As to what constitutes a trade, profession or business, see **[14.04]** above. As to whether a trade, profession or business is carried on 'in Hong Kong', see [14.05] above.

Where a person's business spans across Hong Kong and another jurisdiction, or where a person carries on a business in Hong Kong and a separate business in another jurisdiction, the person's profits do not come within the scope of section 14(1) if they are not considered to be profits earned 'from' the business carried on in Hong Kong. The case of *Sulley v AG* 2 TC 149 illustrates the issue from a UK perspective. Sulley was a partner in a firm of general merchants and drapers, which carried on business in the US and the UK. He resided in the UK, and all the other partners in New York. He transacted the business of the firm in England, which consisted of purchasing and shipping goods for exportation. The profits of the firm were made by re-sale of the goods in the US. The Court of Exchequer (Cockburn CJ at 150) held that the profits did not accrue in respect of the business transacted in England, but in respect of the 'main business' conducted in New York.

In *Lovell & Christmas Ltd v CT (NZ)* [1908] AC 46, the question for the Privy Council was 'whether the business from which the profits have been derived is a business carried on in New Zealand'. It was held that the profits in question were derived from the taxpayer's business of selling goods on commission in London. In the Privy Council's view, the earlier arrangements the taxpayer entered into in New Zealand to bring goods from New Zealand were not the business from which the profits were derived.

In *Mitchell v Egyptian Hotels Ltd* [1915] AC 1022, a company registered in England for the purpose of carrying on a hotel business in Egypt resolved that its business should be carried on and managed in Egypt by a local board which was independent of the home board in England (except that the English home board fixed the remuneration of the Egyptian board). The company was assessed to income tax in respect of the whole of its profits. It was argued for the Crown that a company could only have one business and that such business necessarily included the passing of annual accounts, the declaration of dividends, and the financial arrangements necessary to enable such dividends to be paid. Lord Parker rejected the argument in these terms (at 1038-1039):

> The trade or business we have to consider is a trade or business from which profits or gains can arise and not the business of disposing of and dividing such profits and gains when they have arisen, and I can see no reason why a corporation any less than an individual should not be engaged in more than one trade or business at the same time.

However, as regards non-resident persons, the case law position is now subject to the so-called Rule 2 in Part 8AA. If a non-resident person has a 'permanent establishment' ('PE') in Hong Kong, the person is regarded as carrying on a trade, profession or business in Hong Kong and the person's profits (or losses) attributable to the PE are deemed to be 'those that the permanent establishment would have made in circumstances where it were a distinct and separate enterprise': see s 50AAK.

Profits 'from' a trade, profession or business carried on in Hong Kong are not necessarily profits 'arising in or derived from Hong Kong', as the structure of section 14(1) 'presupposes that the profits of a business carried on in Hong Kong may accrue from different sources': *CIR v Hang Seng Bank Ltd* [1991] 1 AC 306 at 318, [1990] 3 WLR 1120 (PC). By the same token, profits 'arising in or derived from Hong Kong' are not necessarily profits earned from a trade, profession or business in Hong Kong. For example, profits from Hong Kong stock market transactions may be earned by an overseas company whose Hong Kong branch business is not responsible for earning those profits.

For profits 'arising in or derived from Hong Kong', see [14.07] below.

[14.07] Profits 'arising in or derived from Hong Kong'

Whether or not a profit is considered 'arising in or derived from Hong Kong' is a question of the geographical source of the profit.

Note that the word 'source' has sometimes been used in a different sense, especially in overseas cases, to refer to the trade or business from which profits are made. In Hong Kong, however, s 14(1) 'presupposes that the profits of a business carried on in Hong Kong may accrue from different sources': *CIR v Hang Seng Bank Ltd* [1991] 1 AC 306 at 318, [1990] 3 WLR 1120 (PC). In other words, profits from a trade or business carried on in Hong Kong are not necessarily profits 'arising in or derived from Hong Kong'.

Thus, great caution should be taken in analysing cases on 'source' involving different legislative regimes. What is the source depends on the perspective from which the question is asked. This was the point Arden LJ emphasised in *Ardmore Construction Limited v HMRC* [2018] WLR(D) 385, a point first made by Lord Atkin in *Liquidator, Rhodesia Metals Ltd (in liq) v CT* [1940] AC 774.

Section 2(1) defines the expression 'profits arising in or derived from Hong Kong' to include 'all profits from business transacted in Hong Kong'. However, decided cases have not turned on the terms of this definition. This reflects the judicial

sentiment that the meaning of the expression 'profits arising in or derived from Hong Kong' is not extended by the statutory definition. The Court of Appeal specifically made this point in *CIR v Hang Seng Bank Ltd* [1989] 2 HKLR 236, [1989] HKCU 486 (CA), which was not addressed by the Privy Council on appeal.

There has been judicial discussions on whether or not the phrases 'arising in' and 'derived from' are synonymous: see *CT v Kirk* (1900) AC 588; *CIR v Hong Kong & Whampoa Dock Co Ltd* [1960] 2 HKLR 166, [1960] HKCU 30 (AJ) and *Hang Seng Bank* (Court of Appeal). Whilst there may be some marginal difference in the shades of meaning conveyed by the two phrases, decided cases have not called for a determination of what (if any) the difference is: *Kwong Mile Services Ltd v CIR* (2004) 7 HKCFAR 275, [2004] 3 HKLRD 168, [2004] HKCU 782 (CFA), per Bokhary PJ at para 3-4.

The principles governing the source of profits have been considered in three modern decisions of the Privy Council, namely *Hang Seng Bank* [1991] 1 AC 306, [1990] 3 WLR 1120 (PC); *CIR v HKTVB International Ltd* [1992] 2 AC 397; and *CIR v Orion Caribbean Ltd (in liq)* [1997] 2 HKC 449, [1997] 1 HKLRD 924 (PC), and a number of cases of the Court of Final Appeal, including *ING Baring Securities (Hong Kong) Ltd v CIR* [2008] 1 HKC 1, (2007) 10 HKCFAR 417, [2008] 1 HKLRD 412 (CFA).

It is well established in Hong Kong as in some other jurisdictions that the source of profits is 'always in the last analysis a question of fact': *Hang Seng Bank* (at 322-323). It is a 'hard practical matter of fact to be judged as a practical reality'. It is 'not a technical matter but a commercial one': *ING Baring* (Lord Millett NPJ at para 131). The word 'hard' is not used to connote difficulty but 'to mean hard-nosed in that expression's sense of being realistic': *Kwong Mile* (Bokhary PJ at para 8).

Whilst it is 'impossible to lay down precise rules of law by which the answer to that question is to be determined' (*Hang Seng Bank* at 322–323), there are legal principles directing how the question of fact should be addressed. Misapprehension of these legal principles in the fact-finding process is an error of law, as made by the Board of Review in *ING Baring*. In laying his strong criticism of that error, Ribeiro PJ said (at para 31):

> It is only on the basis of a proper appreciation of the applicable legal principles that it is possible to determine what evidence is relevant and what findings the Board needed to make.

Just because there is no appeal on facts, the appellate court is not precluded from detecting and correcting errors of law buried beneath conclusions ostensibly of fact: *Kwong Mile* (Bokhary PJ at para 31).

Broad guiding principle

In *Hang Seng Bank* [1991] 1 AC 306, [1990] 3 WLR 1120 (PC), the taxpayer was a bank in Hong Kong and the profits in question were those the bank earned from the purchase and resale of (mainly) certificates of deposit in the Singapore and London financial markets. The Commissioner's primary submission to the Privy Council was that:

(1) the business of the bank was one and indivisible and was carried on in Hong Kong;

(2) all the relevant operations were directed from Hong Kong and owed their success to the expertise of the bank's officers employed in Hong Kong;

(3) no overseas branch of the bank was involved in the trading of the certificates of deposits;

(4) the funds used in purchasing the certificates of deposits were part of the bank's assets that arose from the carrying on of the bank's business in Hong Kong;

(5) the overseas trading in the certificates of deposit should not be looked at in the isolation, as they were mere components of the profits of an entire business; and

(6) such profits as a whole arose in or were derived from Hong Kong.

Rejecting the Commissioner's submission, and preferring the view that the source of the profits was the trading transactions effected through brokers in the overseas markets, Lord Bridge (at 318E–F) said of the construction of section 14(1) that:

> Three conditions must be satisfied before a charge to tax can arise under section 14: (1) the taxpayer must carry on a trade, profession or business in Hong Kong; (2) the profits to be charged must be 'from such trade, profession or business,' ... ; (3) the profits must be 'profits arising in or derived from' Hong Kong. Thus the structure of the section presupposes that the profits of a business carried on in Hong Kong may accrue from different sources, some located within Hong Kong, others overseas. The former are taxable, the latter are not. On the commissioner's submission the requirement of condition (3) would be otiose, since it would be sufficient to show that profits were earned by a business carried on in Hong Kong to make them taxable.

It follows that a distinction must fall to be made between profits of a source in Hong Kong and those of an offshore source 'according to the nature of the different transactions by which the profits are generated' (at 319B) and not according to where the taxpayer carries on or controls its business.

Lord Bridge (at 322–323) described the 'broad guiding principle' thus:

> ... The broad guiding principle, attested by many authorities, is that one looks to see what the taxpayer has done to earn the profit in question. If he has rendered a service or engaged in an activity such as the manufacture of goods, the profit will have arisen or derived from the place where the service was rendered or the profit making activity carried on. But if the profit was earned by the exploitation of property assets as by letting property, lending money or dealing in commodities or securities by buying and reselling at a profit, the profit will have arisen in or derived from the place where the property was let, the money was lent or the contracts of purchase and sale were effected.

The 'broad guiding principle' as such is not a universal test (*Kwong Mile Services Ltd v CIR* (2004) 7 HKCFAR 275, [2004] 3 HKLRD 168, [2004] HKCU 782 (CFA), per Bokhary PJ at para 12). In relation to a loan of money, for example,

Lord Bridge was not laying down a rule of law to the effect that the source of interest income from the loan is always located in the place where the money was lent (*CIR v Orion Caribbean Ltd (in liq)* [1997] 2 HKC 449, [1997] 1 HKLRD 924 (PC) at para 28).

In the context of its facts, the *Hang Seng Bank* case is illustrative of a fundamental aspect of the 'broad guiding principle' – that is, a degree of proximity is required in seeing 'what the taxpayer has done to earn the profit'. The Privy Council's judgment shows that the relevant operations in *Hang Seng Bank* were not the whole of the taxpayer's operations but the particular operations or transactions that produced the profits in a proximate sense. Identifying these profit-producing operations or transactions was not a matter of weighing the relative commercial importance of every facet of the taxpayer's business. Rather, it was a matter of identifying the proximate cause of the profit. This aspect of the 'broad guiding principle' was clarified by the Court of Final Appeal in *ING Baring Securities (Hong Kong) Ltd v CIR* [2008] 1 HKC 1, (2007) 10 HKCFAR 417, [2008] 1 HKLRD 412 (CFA).

In *CIT v Chunilal Mehta* (1938) LR 65 Ind App 332, the Privy Council rejected the argument that the place at which the taxpayer made decisions to enter into transactions was the place at which the relevant profits arose, noting that those decisions were neither the proximate cause nor the whole of the cause of the profits.

In *CIR v HKTVB International Ltd* [1992] 2 AC 397, the Privy Council followed the 'broad guiding principle' and held that the particular profit-producing transactions were twofold: namely, the acquisition of exclusive rights to grant sub-licences together with the relevant films and the grant of those sub-licences together with provision of the films to customers. On *HKTVB*'s own particular facts, the Privy Council held that the twofold transactions took place in Hong Kong.

Lord Jauncey (at 409) added that 'it can only be in rare cases that a taxpayer with a principal place of business in Hong Kong can earn profits which are not chargeable to profits tax under section 14'. This must be true in the sense that the overwhelming majority of business operators in Hong Kong carry out their profit-producing transactions in Hong Kong. But this does not mean that the kinds of financial transactions in *Hang Seng Bank* and *ING Baring* are rarely seen in the financial market. It may also be said that investments generating offshore interest or dividend income are not rare types of investments. It seems that Lord Jauncey's statement in this regard should be understood only in relative terms and that the degree of rareness of a case cannot be a criterion for determining the source of profits.

Another case that applied the 'broad guiding principle' in the 1990s was *Magna Industrial Co Ltd v CIR* [1996] 4 HKC 55, [1997] HKLRD 173 (CA), where the Court of Appeal upheld the Board of Review's approach in determining the source of the profits which the taxpayer made from sale of products through an overseas network of independent contractors. The Board considered the totality of the facts and found that the true source of the profits was the sales effected outside Hong Kong by the independent contractors. Everything else, such as invoicing, shipping, payment collection, was considered ancillary. The Board also said that its finding would have been the same even if the taxpayer itself had warehoused, labelled and re-packaged products in Hong Kong.

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INLAND REVENUE (DOUBLE TAXATION RELIEF AND PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL) (REPUBLIC OF AUSTRIA) ORDER

(CAP 112BO)

(Cap. 112, section 49(1A))

(Enacting provision omitted—E.R. 4 of 2020)

[9 December 2010]
(Format changes—E.R. 4 of 2020)

1. *(Omitted as spent—E.R. 4 of 2020)*

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2. Declaration under section 49(1A)

For the purposes of section 49(1A) of the Ordinance, it is declared—

(a) that the arrangements specified in section 3(1) have been made with the Government of the Republic of Austria with a view to affording relief from double taxation in relation to income tax and any tax of a similar character imposed by the laws of the Republic; and

(b) that it is expedient that those arrangements should have effect.

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3. Arrangements specified

(1) The arrangements specified for the purposes of section 2(a) are the arrangements in—

(a) Articles 1 to 28 of the agreement titled "Agreement between the Government of the Hong Kong Special Administrative Region of the People's Republic of China and the Government of the Republic of

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PUBLISHER'S INTRODUCTION

The Butterworths Hong Kong Inland Revenue Handbook aims to provide a comprehensive guide to the full text of Inland Revenue Ordinance (Cap 112), its practice and procedures, as well as recent legislative and judicial developments.

The annotations in this edition encompass notes ranging from definitions of words and phrases to discussions on practical aspects and contentious issues relating to particular sections and other authoritative materials. Furthermore, the annotations are fully cross-referenced, and the Handbook comes with comprehensive tables of cases, legislation and other sources referred to.

While this Handbook does not claim to be an exhaustive reference, it is hoped that it may prevent the need for unnecessary labour and research. The Publisher has taken all care and effort to ensure that the legislative provisions reproduced in this Handbook are accurate and up-to-date, but takes no responsibility for any inaccuracies or omissions contained therein or for any advice, action or inaction based thereon.

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