Source of Profits Principle: 1998 Restatement

New amendments to the Departmental Interpretation and Practice Note 21 dealing with the location of profits brings the IRD in-line with recent Court decisions

Amending Departmental Interpretation and Practice Note 21, entitled 'Location of Profits' (DIPN 21), will be like painting the new Tsing Ma Bridge – once you are finished, you will then be required to start all over again. Most recently, changes in the law that were a direct result of the decisions in *CIR v Orion Caribbean Ltd* [1997] 2 HKC 449 and *CIR v Magna Industrial Co Ltd* [1996] 4 HKC 55 prompted yet further amendments to DIPN 21 (revised March 1998; previously revised, April 1996).

On this latest occasion the amendments were undoubtedly necessary as the decisions noted above were clearly at odds with previously published IRD practice (see DIPN 21, April 1996 revision). The newly amended DIPN 21 sets out the IRD's response to these decisions and other rather less contentious items such as the source of rebate commissions and royalty income. The IRD is also prepared to provide advance rulings, for a fee, on source of profits issues.

Basic principles

DIPN 21 opens with a useful comment. Although reaffirming the broad, guiding principle laid-out in *CIR v Hang Seng Bank* [1991] 1 AC 306 that 'one looks to see what the taxpayer had done to earn the profits in question and where he has done it', DIPN 21 goes on to note that 'no single legal test can be employed'. This latter statement, reflecting comments made in the subsequent Privy Council case of *Orion Caribbean*, clearly reminds us that it would be inappropriate to read the illustrative examples given in *Hang Seng Bank* as absolute law. Thus, for example, that source of interest income is generally, but not always, determined by where the credit was provided to the borrower.

Rare case dictum

Interestingly, included by the Commissioner in the new amendments, despite being years after the event, is the so-called 'rare case' dictum of the Privy Council in *CIR v HK-TVB* [1992] 2 AC 397 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.'

In quoting this sentence, the Commissioner's intent seems clear. Practitioners can expect regular recourse to this stricture in source of profits battles to come.

... source of interest income is generally, but not always, determined by where the credit was provided to the borrower

Source of trading profits

Specifically in relation to the source of trading profits and the *Magna Industrial* case, the Commissioner retains the view that the locality of profits from trading in goods and commodities is generally the place where the contracts for purchase and sale are 'effected'. But he then goes on to state:

'However, as the Court of Appeal noted in *Magna* the totality of facts must be looked at in determining what the taxpayer did to earn the profit: "*the question where the goods were* purchased and sold is important. But there are other questions. For example, How were the goods procured and stored? How were the sales solicited? How were the orders processed? How were the goods shipped? How was the financing arranged? How was the payment effected?" This reflected the statement of the High Court that: "more often than not, it would not be the quantity of activities but the nature and quality of them that matters more. The cause and effect of such activities on the profits that is the determining factor."'

It is clear from continuing disputes relating to the source of trading profits (see, eg, *D51/97* 12 IRBRD 338), as well as from the terms of the decision in *Magna Industrial* itself (where the Court of Appeal indicated that the case 'fell on the extreme limits of the spectrum'), that this area is far from settled – at least in the minds of taxpayers and their professional advisers. But notwithstanding this comment, the Commissioner's interpretation of *Magna Industrial* seems to be a fair reading of the Court of Appeal's decision.

Royalty income

The amendments then go on to state the source of royalty income. The Commissioner's attempt is clearly necessary after the Privy Council decision in *HK-TVB International* which, interestingly, was ignored in previous versions of DIPN 21. The Commissioner opines:

'Royalties other than those deemed chargeable under s 15(1)(a) or (b) [are] determined on the same basis as trading profits.'

However, the issue of whether the courts will uphold this statement can only be described is moot.

Income of investment advisers

In a further amendment, the Commissioner alludes to the case *of CIR v Wardley Investment* (1992) 3 HKTC 703 by stating that where an investment adviser's organisation and operations are located entirely in Hong Kong, profits derived in respect of the management of the clients' funds are considered to have a Hong Kong source. Included in taxable profits are management and performance fees as well as rebates, discounts and commissions received by an adviser from brokers located in or outside Hong Kong with regard to securities transactions executed on behalf of clients (readers interested in this issue should refer to *D71/97* 12 IRBRD 410 for an illuminating and useful analysis of the *Wardley Investment* case).

Advance rulings

In an attempt to provide further certainty in this area, the IRD will now provide advance rulings (on a full fee basis) on the locality of profits (see DIPN 31).

Andrew Halkyard
teaches Revenue Law at the
University of Hong Kong and is a
consultant to Baker & McKenzie

利潤來源的原則：1998 年重申

處理利潤所在地的《部門釋義與實務説明第 21 號》的最新修訂，把稅務局與近期法院判決串聯起來

對標題為「利潤所在地」的《部門釋義與實務説明第 21 號》作出修訂，就好像替新青馬大橋塗油漆：當你完成後，你便須再由頭從新開始。最近，由 *CIR v Magna Industrial Co Ltd* [1996] 4 HKC 55 和 *CIR v Orion Caribbean Ltd* [1997] 2 HKC 449 的判決直接引起的法律改變，促使了《部門釋義與實務説明第 21 號》（於 1996 年 4 月及 1998 年 3 月修訂）的再次修訂。

無疑這次最新的修訂是必需的，原因是上述的判決顯然與先前出版的稅務局實務（詳見《部門釋義與實務説明第 21 號》1996 年 4 月修訂版）不一致。新修訂的《部門釋義與實務説明第 21 號》陳述了稅務局對這些判決的回應，以及其他爭議性較少的項目，例如退還佣金及專利權稅收入的來源。稅務局亦已準備，在須徵收費用的條件下，就利潤來源的爭論點預先提供裁定。

基本原則

《部門釋義與實務説明第 21 號》以一個有用的意見作開始 。雖然該實務説明再次確認於 *CIR v Hang Seng Bank* [1991] 1 AC 306 敍述的概括、具有指導性的原則，即「須看納稅人做了什麼以賺取有關的利潤，以及他在何處做那事」，但實務説明接著便指出「沒有單一個法律準則可以使用」。這陳述既反映了英國樞密院後來在 *Orion Caribbean* 一案中所作的意見，亦清楚地提醒了我們，把 *Hang Seng Bank* 案中提供的解説性例子視為絕對法律，是絕不恰當的。因此，舉例説，利息收入的來源，通常但非一定是把信貸提供予借貸人的地點來決定。

利息收入的來源，
通常但非一定是
把信貸提供予
借貸人的地點來決定

「罕有情況」的附帶意見

有趣的是，稅務局局長在新的修訂中，包括了多年前英國樞密院在 *CIR v HK-TVB International* [1992] 2 AC 397 中所作的所謂「罕有情況」附帶意見。該意見如下：

「只有在罕有的情況下，一名主要營業地址在香港的納稅人，方可賺取無須繳付利得稅的利潤。」

在引用這句子時，局長的原意似乎相當清楚。執業律師們可望在未來關於利潤來源的爭拗中，會經常出現向上述約束所作的依賴。

貿易利潤的來源

特別有關貿易利潤的來源及 *Magna Industrial* 一案而言，局長保留以下觀點，即整體來説，貨物及商品貿易帶來的利潤的所在地，乃買賣合約「實行」的地方。但局長接著陳述如下：

「可是，正如上訴法庭在 *Magna* 一案中指出，要決定納稅人做了什麼以賺取利潤，必須細看事實的整體：『貨物在何處買入及售出固然是重要的問題，但亦有其他的問題，例如：如何取得及儲存貨物？如何招攬銷售？如何處理訂貨單？如何運送貨物？如何安排融資？如何實行付款？』這反映了高等法院以下的陳述：『有很多時候，較要緊的並非活動的數量，而是它們的性質及特性。此等活動與利潤的因果關係，乃是決定性的因素。』」

從接踵而來的有關貿易利潤來源的爭議 ➤

(例如 *D51/97* 12 IRBRD 338)，以及 *Magna Industrial* 一案本身的判決的措辭（在案中，上訴法庭表示該案「落在有關範圍的極限」），可清楚見到，至少對於納稅人及其專業顧問來說，這一方面的法律尚未穩固確立。但儘管如此，局長對於 *Magna Industrial* 一案的釋義，似乎是對上訴法庭判決的一個中肯的看法。

專利權稅收入

修訂接著便陳述專利權稅收入的來源。鑒於英國樞密院於 *HK-TVB International* 一案的判決，局長的嘗試是必需的；但有趣的是，該判決在《部門釋義與實務說明第 21 號》的各個早期版本均忽視該判決。局長作出以下意見：

「除了根據第 15(1)(a) 或 (b) 條被視為應課稅的之外，專利權〔是〕按貿易利潤的基準決定。」

但各級法院會否支持這項陳述，只可說是一個辯論的題目。

投資顧問的入息

在另一個修訂中，局長陳述，當一名投資顧問的組織和運作完全是於香港境內進行時，與管理客戶基金有關而得到的利潤，將被看作為來源自香港。局長所指的是 *CIR v Wardley Investment* (1992) 3 HKTC 703。須繳稅的利潤，包括管理與履行費用，以及顧問由香港境內或境外的經紀所收、有關於代表客戶執行證券交易的退款、折扣及佣金。（對此題目感興趣的讀者，應參閱 *D71/97* 12 IRBRD 410，該案對 *Wardley Investment* 一案作出了富有啟發性及有用的分析。）

預先裁定

為嘗試對這整個範圍提供進一步的確實性，稅務局現可就利潤的所在地，在十足費用的基準上提供預先裁定（詳見《部門釋義與實務說明第 31 號》）。

賀雅德
於香港大學執教稅務法，
並為麥堅時律師行的顧問