



6 June 2008

Our Ref.: C/TXG, M56672

Mr. Chiu Kwok-kit
Assistant Commissioner of Inland Revenue, Unit 1
GPO Box 132
Hong Kong

Dear Mr. Chiu

Source of Profits

Thank you for your letter dated [2 May 2008](#) replying to the issues raised in our letter to the Commissioner of Inland Revenue dated [25 January 2008](#). We appreciate you taking the time to provide written responses indicating the Inland Revenue Department's position on source of profits, following the decision of the Court of Final Appeal ("CFA") in the case of ING Baring Securities (Hong Kong) Limited v CIR (Final Appeal 19 of 2006 (Civil)) ("*ING Baring*"). We would like to take this opportunity to seek the Department's clarification on the following matters arising from the Department's letter.

Firstly, we are pleased to note that we are in agreement that there is no new law in the decision in *ING Baring*. As stated in paragraph 5 of our previous letter, we believe that "*there is no new law in the decision but, rather, a well-reasoned and well-presented summary of the law and its application*".

That said, we are confused about the Department's position on a "totality of facts test" for determining the source of a profit, when viewed in the light of the current version of DIPN No. 21. In particular, the Department states in its response to paragraph 17 that it:

"does not accept the comment that it has adopted any "totality of facts test" in deciding the source of profit."

This statement appears to be at odds with the position outlined in paragraphs 6 and 8 of the current DIPN No. 21 (when determining the relevant approach for determining source of trading profits). In paragraph 6 of DIPN No. 21, the Department states that:

"...the totality of facts must be looked at in determining what the taxpayer did to earn the profit..."

and in paragraph 8:

"...the Department's views which are reflected in assessing practice on the locality of profits derived from the trading in commodities or goods by



a business carried on in Hong Kong...:[are](g) the purchase and sale contracts are important factors but the totality of facts must be looked at to determine the locality of the profits.”

In the light of the above, can you confirm that the comments in DIPN No. 21 no longer represent the current views of the Department and that the DIPN will be amended to reflect this.

We also do not agree with certain aspects of the advice obtained by the Commissioner of Inland Revenue from counsel in relation to the CFA’s decision in *ING Baring* (“Paragraphs 3 and 4” of the Department’s letter). In particular, we do not agree that the CFA’s decision:

“(b) ...represents a particular way of looking at the facts in stockbroker cases, where the profit in issue arises from commissions or similar incomes.

(c) ...can be regarded as being entirely dependent on a factual analysis.”

In our view, the CFA’s decision in *ING Baring* has a broad application for determining the source of profits (not just for stockbroker cases involving profits arising from commissions or similar incomes). In particular, the CFA’s decision confirms the importance of identifying and considering the particular transaction that gives rise to the profits concerned. That this is intended to have a broad application seems clear to us from the pains that the court took to analyse the errors made in the approach adopted by the Board of Review:

“The Board.... sought to apply Lord Jauncey’s formulation of the fundamental question in HKTvBI at p.411 as ‘what were the operations of the taxpayer which produced the relevant profit’. But it failed to appreciate that the concluding words ‘which produced the relevant profit’ are words of limitation which restrict the enquiry to the particular operations which earn the profit. Nor did it heed the direction of the Privy Council in Mehta to look at the profit-making transactions separately and consider the profits of each transaction by itself..... It sought to identify all the activities in which the Taxpayer engaged in the course of its business on the footing that they all contributed in varying degrees of importance to its ability to make profits, and to determine which of them took place in Hong Kong and which elsewhere. Even if it had succeeded in doing this, it is unclear to me how it would have helped to resolve the question in issue ”.
(Lord Millett NPJ, at paragraph 159).

The decision is also an unambiguous reiteration of the principle that the tests of carrying on a business in Hong Kong and determining of the source of profits are two separate, distinct tests to be ascertained independently and with regard to different factors.



Finally, the Department indicates that it will update the current version of DIPN No. 21 in due course, taking into account the more recent decisions by the courts and the board of review. We would ask that the Department provide a clear timetable for its revision of the DIPN, indicating when a draft revised version will be circulated for discussion and comment.

Yours sincerely,

A handwritten signature in black ink that reads 'Peter Tisman'. The signature is written in a cursive, flowing style.

Peter Tisman
Director, Specialist Practices

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