

Hong Kong (SAR) Tax Alert

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A court case on taxability of profits from container trading and leasing

Summary

The Court of First Instance (CFI) handed down its judgment in *Touax Container Investment Limited v Commissioner of Inland Revenue*¹ on 30 August 2024.

The CFI ruled that the Board of Review (the Board) did not err in concluding that the taxpayer carried on a trade or business in Hong Kong but erred in its approach to ascertaining that the source of the taxpayer's profits from container trading and leasing businesses were sourced in Hong Kong. The CFI ruled that there was insufficient finding of facts by the Board to ascertain the source of the profits, so remitted the case to the Board for a rehearing.

In this tax alert, we summarise the CFI's analysis and discuss our observations on the case.



Background

The taxpayer is a Hong Kong-incorporated company engaged in the business of sale and leasing of shipping containers.

During the years of assessment (YOAs) concerned, the taxpayer declared a Hong Kong address (which is the office address of its company secretary) as its registered office and principal place of business in its audited financial statements. It purchased shipping containers and leased them to a related company in Singapore (SG Co), which then subleased the same to unrelated lessees outside Hong Kong. The taxpayer asserted that it had no business assets, bank accounts, employees or agents acting on its behalf in Hong Kong. It claimed that all the profit producing activities were done by its non-Hong Kong resident directors outside Hong Kong.

SG Co also acted as the manager for the leased shipping containers and was responsible for the repair and maintenance of shipping containers on behalf of the taxpayer. Under a lease agreement between the taxpayer and SG Co (the Lease Agreement), SG Co distributed 94.5% of the profits generated from the sub-leasing of the containers to the taxpayer and retained the remaining as commission.

The issues in dispute

The case concerned an appeal by the taxpayer against the Board's decision in Case No. D25/22³. The two issues in dispute are (1) whether the taxpayer carried on a trade or business in Hong Kong and (2) whether the Board erred in (i) its approach to ascertaining the source of the taxpayer's container trading and leasing profits and (ii) concluding that the container leasing profits were sourced in Hong Kong.

¹ The CFI judgment can be accessed via this link: https://legalref.judiciary.hk/lrs/common/ju/ju_frame.jsp?DIS=162365&currpage=T

² The taxpayer filed employer's returns for three individuals for YOA 2013/14 but subsequently claimed that the returns were erroneously filed and that the individuals were employees of the Hong Kong branch of another group company in the US.

³ The Board of Review decision can be accessed via this link: <https://www.info.gov.hk/bor/en/decisions/D2522.pdf>

The CFI's judgment and analyses

Below is a summary of the CFI's judgment and analyses on the above two issues.

Issue 1: Whether the taxpayer carried on a trade or business in Hong Kong?

- The Board held that the taxpayer carried on a business in Hong Kong based on its findings from the documentary evidence available – i.e. a Hong Kong address was (i) declared as its registered address and principal place of business in its audited financial statements and (ii) used in various transactional documents with suppliers and customers (e.g. purchase contracts/agreements, order confirmations, invoices issued by and to the taxpayer).
- The CFI held that it is open to the Board to rely on the documentary evidence available to make a finding that the taxpayer carried on business in Hong Kong. It is not for the court to re-weigh the evidence (by giving overriding weight to certain evidence and ignoring the other evidence relied upon by the Board) and come to a different conclusion.
- As the Board's conclusion is not contrary to the only true and reasonable conclusion, it is not for the court to interfere with the Board's conclusion.
- Based on the above, the CFI held the Board did not err in concluding that the taxpayer carried on a trade or business in Hong Kong.

KPMG observations

Other than the above analyses, the CFI judge also made the following notable comments:

- Not much activity is necessary to constitute the carrying on of a business.
- The taxpayer's Hong Kong address was not merely "brass plate" – the address was consistently and repeatedly used in the taxpayer's trading transactions and appeared in various transactional documents.
- *Newfair Holdings Limited v CIR*⁴ did not establish any principle that having a registered address in Hong Kong as a formality of corporate law is by itself insufficient to constitute the conduct of a trade or business in Hong Kong. In the CFI judge's view, the decision in the *Newfair* case was based on the specific facts of the case. Similar comment was made by the same CFI judge in *Patrick Cox Asia Limited v CIR*⁵ as obiter dictum.

Companies with a registered address in Hong Kong as a formality of corporate law or declaring a Hong Kong address as its principal place of business should be mindful that such fact may undermine any argument that the companies are not carrying on a business in Hong Kong. In such cases, strong evidence has to be produced to support the claim of not carrying on a business in Hong Kong as the burden of proof is on taxpayers.

Issue 2: Whether the container trading and leasing profits were sourced from Hong Kong?

- The Board in this case came to the positive view that the taxpayer had profit-producing operations in Hong Kong. However, the Board had not made clear what those operations were. In addition, the reasoning of the Board suggests that its decision was arrived at by reference to irrelevant factors (e.g. signing of an employment contract) and that it is unclear to the CFI whether proper regard was made to the relevant factors.
- The Board erred to the extent of (i) relying on a clause in the Lease Agreement (which did not shed any light on the source of the leasing profits) and (ii) its finding that there was no evidence as to where the Lease Agreement was made to fortify its view that the leasing profits were sourced in Hong Kong.
- Even if the Board found that the taxpayer failed to prove its case that it had no operations in Hong Kong, on the facts found, it is simply not possible to tell the source of the taxpayer's profits.
- To properly identify the source of the taxpayer's profits, the Board should have (i) distinguished between the taxpayer's trading operations and leasing operations and (ii) made findings as to where these operations were carried out.
- Based on the above, the CFI concluded that (i) there are insufficient fact findings made by the Board to conclude whether the trading and leasing profits were sourced in or outside Hong Kong and (ii) the Board erred in its reasoning on concluding that the profits were sourced in Hong Kong. The CFI therefore made an order to remit the case to the Board for a rehearing.

⁴ In the *Newfair* case, the CFI held that the taxpayer did not carry on any trade or business in Hong Kong although it had a registered office in Hong Kong. For more details of the case, please refer to our [Hong Kong \(SAR\) Tax Alert – Issue 5, April 2022](#).

⁵ For more details of the case, please refer to our [Hong Kong \(SAR\) Tax Alert - Issue 24, December 2023](#).

KPMG Observations

Currently, the IRD generally adopts the “operation test” to determine the source of profits from leasing of movable property while the international norm is to look at the place of use of the movable property. The final outcome of this case would set a precedent in Hong Kong on the source rule for profits from leasing of movable property. Hopefully, this would provide greater certainty to taxpayers and reduce potential disputes between the IRD and taxpayers on the source issue going forward.

This case also illustrates that when the Board fails to properly discharge its fact finding duty or errs in the reasoning of its conclusion, challenging the Board’s decision by appealing to a court remains a viable option.

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