HCIA 4/2023
[2023] HKCFI 2676

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE

INLAND REVENUE APPEAL NO. 4 OF 2023

BETWEEN

PATRICK COX ASIA LIMITED Appellant

and

THE COMMISSIONER OF INLAND REVENUE Respondent

Before: Hon Cheng J in Court
Date of Hearing: 6 September 2023
Date of Judgment: 19 October 2023

J U D G M E N T

A. INTRODUCTION

1. The Appellant ("**the Taxpayer**") appeals against the decision of the Inland Revenue Board of Review ("**the Board**") of 17th March 2023 ("**the Decision**").

2. The Taxpayer was incorporated in Hong Kong by its parent company (Hookedge UK) to exploit certain trademarks which were owned

by Hookedge UK and licensed to the Taxpayer pursuant to a master licence ("**the Trademarks**"; "**the Master Licence**").

3. The Taxpayer wished to exploit the Trademarks in a number of jurisdictions, including Japan. On 21st January 2009, the Taxpayer (then known as Hookedge Limited) entered into an agreement with British Luxury Brands Group Ltd ("**BLBG**") ("**the Deed of Cooperation**") for this purpose. Under the Deed of Cooperation, the Taxpayer was to grant sub-licences to Japanese companies introduced by BLBG, for the use of the Trademarks.

3.1 Under clause 5.2 of the Deed of Cooperation, BLBG was to make an upfront payment of £500,000 to the Taxpayer ("**the Upfront Payment**"), upon the signing of the deed, as an initial fee for obtaining the right to participate in the management of the Business and the sharing of profits therefrom. (The Business was defined as the design, manufacture, distribution and sale of certain product under the Trademarks in Japan.)

3.2 Under clause 6.1 of the Deed of Cooperation, the royalty income received by the Taxpayer was to be shared between the Taxpayer and BLBG in the ratio of 40:60, subject to the Taxpayer's entitlement to retain US$750,000 of the gross royalty income received each year.

4. The Taxpayer's appeal is concerned with the chargeability to profits tax of the Upfront Payment and its 40% share of royalties ("**the 40% Royalties**") for the four years of assessment of 2009/10 to 2012/13.

5. The Taxpayer appeals on the following grounds:

5.1 whether the Board erred in concluding that the Taxpayer carried on its business of licensing the Trademarks in Hong Kong within the meaning of s.14 Inland Revenue Ordinance ("**the IRO**") in particular by virtue of: (1) the designation of a Hong Kong business address in the director's report annexed to the Taxpayer's financial statements, (2) the fact that the Taxpayer obtained the right to licence the Trademarks from Hookedge UK pursuant to a board meeting of Hookedge UK held in Hong Kong; and (3) that the Taxpayer was from its incorporation "set up to carry on the business of sub-licensing the Trademarks … in Hong Kong" ("**Ground 1**");

5.2 whether the Board erred in applying the affirmed and complementary "hard practical matter of fact" and "operations test" approaches to ascertaining the locality of profits for the purposes of s.14 IRO as approved by the Privy Council in, respectively, *CIR v Hang Seng Bank* [1991] 1 AC 306 at 322-323, and *CIR v HK-TVB International Ltd* [1992] 2 HKLR 191 at 196, in concluding that the proximate source of the 40% Royalties and the Upfront Payment were operations conducted in Hong Kong and, in particular, by failing to apply the ratio in *Mehta v Commissioner of Income Tax* (1938) LR 65 IA 332 that where Party A carries on its business through operations conducted by Party B on behalf of Party A, then Party A's profits are sourced where Party B conducts those operations on behalf of Party A ("**Ground 2**");

5.3 specifically as regards the Upfront Payment, whether the Board erred in holding that this was a revenue receipt, and not a capital receipt, in the hands of the Taxpayer ("**Ground 3**").

B. GROUND 1: WHETHER THE TAXPAYER CARRIED ON ITS BUSINESS IN HONG KONG

6. The issue under this ground of appeal is whether the Taxpayer carried on its trade or business in Hong Kong.

B1. The applicable principles

7. Section 14(1) IRO provides that:

> "…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."

8. Three conditions have to be satisfied before a charge to tax arises under s.14:

8.1 the taxpayer must carry on a trade, profession or business in Hong Kong;

8.2 the profits to be charged must be "from such trade, profession or business", which means from the trade, profession or business carried on by the taxpayer in Hong Kong; and

8.3 the profits must be "profits arising in or derived from" Hong Kong.

See *CIR v Hang Seng Bank Ltd* [1991] 1 AC 306 at 318E-F (Lord Bridge).

9. In other words, Ground 1 is concerned with the first condition.

B2. The Taxpayer's case

10. The Taxpayer does not dispute that it carried on the trade of licensing the Trademarks. It also does not dispute that it carried on, in Hong Kong, licensing operations regarding marks registered outside Japan.[1] As Mr Stefano Mariani, solicitor-advocate for the Taxpayer, explained at the hearing, Hookedge UK granted a licence to the Taxpayer to exploit the Trademarks in Asia.

11. Rather, the Taxpayer's argument (as advanced at the hearing) is that the Board erred in finding that the Taxpayer carried on a *specific* trade of licensing the Trademarks to Japanese sub-licensees in Hong Kong.[2]

12. I agree with the Respondent ("**the Commissioner**") that the Board did not in fact make such a finding. The Board's finding is that the Taxpayer carried on a trade or business in Hong Kong, and that this business was the business of licensing the Trademarks (whether in Japan or other locations): see Decision at [85] to [97]. There was no finding that the Taxpayer had multiple separate businesses, with each one being located in the specific geographical territory where each sub-licensee was to be found.

13. Whether a taxpayer has one or more businesses is a question of fact: *River Estates Sdn Bhd v Director General of Inland Revenue* [1984]

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1 Taxpayer's skeleton paragraph 20.

2 Taxpayer's skeleton paragraph 20.

STC 60 at 62h-j (Lord Scarman). The Taxpayer did not obtain leave to challenge the Board's findings on the grounds that the Board erred in failing to find that the Taxpayer conducted multiple businesses and that one of these businesses was not conducted in Hong Kong. It is not open to the Taxpayer to seek to do so now.[3]

14. Indeed, Mr Mariani acknowledged that before the Board, it was not argued that the Taxpayer had a discrete trade of licensing the Trademarks to Japanese sub-licensees which was not carried on in Hong Kong. It therefore cannot be said that the Board erred in failing to accept the argument.

15. Furthermore, the Taxpayer accepts that it carried out some part of its business of licensing operations in Hong Kong.[4] As counsel for the Commissioner, Mr Julian Lam, pointed out, if the Taxpayer only had one business, it follows that that business must have been carried on in Hong Kong.

16. The above points suffice to dispose of Ground 1. In any event, even if it were necessary to go further to consider whether the Board erred in concluding that the Taxpayer carried on its (single) business of licensing the Trademarks in Hong Kong, this must be a question of fact. The Board based its finding in this regard on a number of pieces of evidence, including the following:

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[3] In any event, the fact that there may be profit-producing activities outside Hong Kong does not necessarily mean that no business is carried on in Hong Kong. The profits of a business carried on in Hong Kong may accrue from different sources some located within Hong Kong, others overseas: *CIR v Hang Seng Bank* at 318F (Lord Bridge). The first and third conditions under section 14 IRO should not be elided.

[4] Taxpayer's skeleton paragraph 20.

16.1 the Taxpayer's own director's report described its principal activity as the generation of royalty income and its principal place of business as the registered office in Hong Kong (Decision at [87]);

16.2 the Taxpayer's evidence was that it had been set up (in Hong Kong) by Hookedge UK and had been granted the Master Licence in Hong Kong to use the Trademarks; the business set-up in Hong Kong was carefully devised after taking into account various different considerations including commercial, tax and convenience considerations (Decision at [94] to [96]);

16.3 the Taxpayer's case was that it was set up to facilitate control and business development in the Asia-Pacific region (Decision at [23(1)]);

16.4 the minutes of Hookedge UK's board meeting of 26th January 2009 noted that the Taxpayer had been incorporated in Hong Kong for the purposes of developing, promoting and managing the distribution and sale of products bearing the Trademarks, through licensing or other means, in the Asia-Pacific region, and recorded the grant of a Master Licence to the Taxpayer for this purpose; (Decision at [23(6)]);

16.5 the Taxpayer conducted various business operations in Hong Kong, including the entering into of the Deed of Cooperation, and entering into sub-licences with various Japanese sub-licensees (Decision at [89], [98]);

16.6 the Taxpayer maintained an office in Hong Kong for its operations (Decision at [113]);

16.7 Antares Cheng, the Taxpayer's only decision maker, was based in Hong Kong, so that he would have carried out his activities in Hong Kong (Decision at [96]);[5]

16.8 Ricky Li and Simon Low-nang, directors of Hookedge UK, resided in Hong Kong and acted on behalf of the Taxpayer in Hong Kong (Decision at [105]).

17. Under Ground 1, the Taxpayer seeks to challenge only three of these matters. This in itself is insufficient to overturn the Board's finding of fact, as the question is whether there is evidence to support that finding, and not whether each and every single piece of evidence supports that finding, or how the various pieces of evidence should have been weighed and evaluated by the fact-finding tribunal. See *CIR v Inland Revenue Board of Review* [1989] 2 HKLR 40 at 56F-H, 57F-H (Barnett J). Furthermore, as G Lam J (as he then was) said in *CIR v Right Margin Ltd* [2017] 5 HKLRD 398 at [10]:

> "It is well-established that attacks on findings of fact only raise questions of law in very limited circumstances, such as where it is said there is no evidence at all to support the finding. The extent to which a particular piece of evidence should be accepted or rejected, and the weight to be given to it, are matters for the Board and not the court…"

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[5] Insofar as the Taxpayer seeks to rely on a lack of evidence as to what Antares Cheng did (cf. Taxpayer's skeleton paragraphs 29 to 31), it is not open to it to do so, as it chose not to call Antares Cheng to give evidence before the Board: cf. *Kim Eng Securities (Hong Kong) Ltd v CIR* (2007) 10 HKCFAR 213 at [50] (Bokhary PJ).

18. As regards the first specific matter complained of by the Taxpayer (that the Board took into account the designation of a Hong Kong business address in the director's report):

18.1 I do not agree that *Newfair Holdings Limited v CIR* [2022] HKCFI 1133 laid down 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.[6] The parts of the decision relied on by the Taxpayer turned on the facts in that case, as can be seen from [37] and [40] of the judgment (Au-Yeung J);

18.2 as Mr Lam pointed out, the Taxpayer's submissions[7] are essentially an argument that the court should re-weigh the evidence. This is impermissible.

19. As regards the second specific matter complained of by the Taxpayer (that the Taxpayer obtained the right to licence the Trademarks from Hookedge UK pursuant to a board meeting of Hookedge UK held in Hong Kong), it seems to me that the Board in this part of the Decision was simply referring to the minutes as part of the evidential background, rather than imputing[8] any act of Hookedge UK to the Taxpayer. Certainly, the Board did not refer to any such imputation.

20. As regards the third specific matter complained of by the Taxpayer (that the Taxpayer was from its incorporation "set up to carry on the business of sub-licensing the Trademarks … in Hong Kong"), this is in

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6 Taxpayer's skeleton paragraph 24.
7 Taxpayer's skeleton paragraphs 23 to 26.
8 Taxpayer's skeleton paragraph 27.

fact the Board's conclusion in Decision at [97] after a consideration of the relevant evidence. Again, it is not for the court to reweigh and reconsider the relevant evidence and come to a different conclusion.

21. The Taxpayer sought to raise an argument about a fourth specific matter, namely, that Antares Cheng only carried out formalities by signing sub-licences for the Taxpayer. No leave was given to challenge the Board in this regard under Ground 1. In any event, as Mr Lam submitted, this wrongly introduces an inquiry as to what were the Taxpayer's profit-producing activities, when the issue under Ground 1 is whether the Taxpayer carried on a trade, profession or business in Hong Kong.

22. Accordingly, I conclude that there is no merit in this ground.

C. GROUND 2: WHETHER THE BOARD ERRED IN APPLICATION OF PRINCIPLES REGARDING SOURCE OF PROFITS

23. The issue under this ground of appeal is whether the 40% Royalties and the Upfront Payment arose in, or were derived from, Hong Kong, or whether they had a non-Hong Kong source.

C1. The applicable principles

24. The Taxpayer accepts that the Board correctly stated the relevant principles (but says that it misdirected itself when it came to their application).

25. The broad guiding principle in determining the source of a taxpayer's profits is to look to see what the taxpayer has done to earn the profit in question, and where he has done it. See *CIR v Hang Seng Bank* at 322H-323A (Lord Bridge); *CIR v HK-TVB International* [1992] 2 HKLR 191 at 196 (Lord Jauncey).

26. The focus is on establishing the geographical location of a taxpayer's profit-producing transactions themselves as distinct from activities which are antecedent or incidental to those transactions: *ING Baring Securities (Hong Kong) Ltd v CIR* (2007) 10 HKCFAR 417 at [38] (Ribeiro PJ).

27. The Taxpayer highlights [139] and [142] of *ING Baring*:

> "139. In considering the source of profits, however, it is not necessary for the taxpayer to establish that the transaction which produced the profit was carried out by him or his agent in the full legal sense. It is sufficient that it was carried out on his behalf and for his account by a person acting on his instructions. Nor does it matter whether the taxpayer was acting on his own account with a view to profit or for the account of a client in return for a commission.
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> …
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> 142. The overseas brokers who carried out the taxpayer's instructions in [*Commissioner of Income Tax, Bombay Presidency and Aden v Chunilal B Mehta of Bombay* (1938) LR 65 Ind App 332] did so as principals and not as agents. But the opinion of the Board contains no reference to agency and does not depend on any supposed identity of the agent and his principal. It was sufficient that the profits arose from transactions entered into by brokers acting on the taxpayer's instructions and for his account. The same was true of *Hang Seng Bank*."

C2. The Taxpayer's profit-making activities

28. In considering the source of the Taxpayer's profits, it is important to first identify what the Taxpayer's profit-producing activities

were. As Mr Lam points out, it is necessary to first identify the profit-producing activities before considering whether any third party's acts constitute part of those activities and whether such acts should be attributed to the taxpayer. Otherwise, confusion is apt to arise.

29. The Board dealt with the question of what the Taxpayer's profit-producing activities were in Decision at [121] to [128]. It held that the Taxpayer's acquisition of the Master Licence from Hookedge UK, and its use of this license to enter into the Deed of Cooperation and the sub-licensing contracts in Hong Kong, were the source of the Taxpayer's profits. At least in relation to the Upfront Payment, the Taxpayer also accepted that what it did to obtain this was to enter into the Deed of Cooperation (Decision at [122]).

30. All of this accords with the provisions in the Deed of Cooperation regarding the parties' respective obligations – in other words, what they had to do in order to earn their respective profits. Under cl.5.1, the Taxpayer was to grant sub-licences to third parties introduced by BLBG, and to procure the cooperation of Hookedge UK in supporting the Business and Licensing Program (as defined thereunder). Under cl.5.2, BLBG had various obligations including, but not limited to, identifying and introducing to the Taxpayer potential sub-licensees, and arranging for negotiations for and on behalf of the Taxpayer as licensor.

31. It is important to note what the Taxpayer's profits were. Under the Deed of Cooperation, the Taxpayer and BLBG were to share the royalty income from the licensing program. The Taxpayer's profits were the 40% Royalties, that is to say, 40% of the gross royalty income (subject to a minimum guaranteed amount under cl.6.1.3). BLBG's profits were

60% of the gross royalty income. The Taxpayer's accounts reflected this by recording the 40% as the Taxpayer's income, rather than 100% less BLBG's share as expenses (Decision at [20]). The Board also recognised that the Taxpayer's profits were confined to the 40% Royalties (Decision at [128]).

32. Thus, the Taxpayer had to perform its obligations (of granting sub-licences) under the Deed of Cooperation in order to earn 40% Royalties. BLBG had to perform *its* obligations (of identifying and introducing sub-licensees, etc) to earn its share of the gross royalty income (as indeed the Board held (Decision at [131])).

C3. The Taxpayer's case

33. Under Ground 2, the Taxpayer says that there are six reasons why the Board misapplied the principles ascertaining the locality of the Taxpayer's profits. It says that:

33.1 BLBG was stated in the recitals of the sub-licences to be the designated agent of the Taxpayer;

33.2 the fact that the Taxpayer executed the Deed of Cooperation and sub-licences in Hong Kong does not mean that the 40% Royalties and the Upfront Payment were sourced in Hong Kong;

33.3 the Taxpayer and BLBG were contractually obliged to carry on the business of licensing the Trademarks in Japan jointly;

33.4 the Board failed to attach due weight to the registration of the Trademarks in Japan;

33.5 the Board erred in relying on the input of Ricky Li, as he acted in the interests of Hookedge UK and not on behalf of the Taxpayer;

33.6 there was no necessary correlation between (on the one hand) Antares Cheng's director's fee being tax deductible in Hong Kong and his paying salaries tax and (on the other hand) the Taxpayer carrying on the specific licensing operations that generated the 40% royalties and the Upfront Payment in Hong Kong.

C3.1 BLBG stated to be designated agent of Taxpayer

34. The Taxpayer relies on the fact that the recital of each of the Japanese sub-licences stated that the Taxpayer had appointed BLBG as its "agent … performing the functions of the representative of the [Taxpayer] in the Licensed Region". It argues that "[t]he principle of agency in the broad sense approved by the Court of Final Appeal in *ING Baring* should therefore in principle have applied".[9] Yet (it is said) the Board found that the most important factor in ascertaining the locality of the Taxpayer's profit was that Antares Cheng was the ultimate decision maker and had the final say as to whether to enter into a sub-licence. The Taxpayer complains that the Board wrongly applied the "brain analogy" to conclude that since Mr Cheng, the ultimate decision maker of the Taxpayer, was located in Hong Kong, the source of the 40% Royalties must have been where he decided to enter into the Deed of Cooperation and the sub - licences. It is said that this failed to focus on the transactions that

[9] Taxpayer's skeleton paragraph 40.

produced the profits, and instead emphasised antecedent or incidental matters that were legally irrelevant.

35. With respect, this submission conflates a number of different points.

36. First of all, as Mr Lam points out, the fact that BLBG was designated as agent under the Deed of Cooperation is irrelevant if BLBG's activities did not produce the Taxpayer's profits. The Taxpayer had to perform its obligations under the Deed of Cooperation (that is, grant sub-licences) to earn its profits, and BLBG had to perform its obligations (that is, identify and introduce sub-licencees and arrange for negotiations) to earn its profits. The acts which BLBG performed were (identifying and introducing sub-licensees to the Taxpayer, and arranging for negotiations) were not carried out on behalf of the Taxpayer in performance of its obligations under the Deed of Cooperation, but rather, by BLBG in performance of its own obligations under the Deed of Cooperation.[10] Thus the mere fact that the recital of the sub-licences stated that the Taxpayer had appointed BLBG as agent would not engage "the principle of agency". It is putting the cart before the horse to say that since BLBG was the Taxpayer's agent, therefore its activities should be attributed to the Taxpayer; the prior question is what were the profit producing activities of the Taxpayer? If such activities did not include what the "agent" did, then the fact that the "agent" was the Taxpayer's agent is nothing to the point.

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[10] This is so even if the arranging for negotiations was, under cl.5.2 of the Deed of Cooperation, expressed to be "on behalf of the [Taxpayer] or any member of the Group". The point is that this was work which BLBG had to do, not work which the Taxpayer had to do.

37. Second, the description of the Board's finding is not a fair representation of what the Board held. I accept Mr Lam's submission that it is not the case that the Board decided the issue of source on the basis that the administration of the Taxpayer took place in Hong Kong. The Board discussed the role of Antares Cheng in the Decision at [101] to [116] in the context of determining that the Deed of Cooperation and the sub-licences were concluded by him in Hong Kong. This arose because the Taxpayer had argued that it was BLBG which had concluded that the contracts in Japan and that the execution by Antares Cheng was a mere formality; the Board held that the contracts were in fact concluded in Hong Kong.

38. I further accept Mr Lam's submission that the Board did not apply the "brain analogy". The Board had reviewed the authorities on source of profits at some length, and observed (from *ING Baring*) that "Use of "a brain analogy" or the place of administration of the business as criteria for ascertaining the geographical source of profits was plainly inconsistent with the decisions in *Mehta* and *Hang Seng* Bank" (see Decision at [65]). The discussion of Antares Cheng being the ultimate decision maker was not for the purpose of concluding that since the Taxpayer's "brain" was located in Hong Kong, its profits were therefore sourced in Hong Kong.

C3.2 Mere execution of Deed of Cooperation and sub-licences in Hong Kong does not mean that 40% Royalties and Upfront Payment sourced in Hong Kong;

39. The Taxpayer says that the mere execution of an agreement is not by itself a profit-making operation. Mr Mariani submitted that what the Taxpayer did to earn its profits was to find potential Japanese

sub - licensees and then negotiate and conclude contracts with them, and that this could not have been done without BLBG.

40. The Taxpayer appears to be suggesting that the sub-licences were concluded in Japan and not in Hong Kong.[11] It is not open to the Taxpayer to do so, this being contrary to the Board's finding of fact that the sub-licences were concluded in Hong Kong (Decision at [116]) (and the Taxpayer not having sought or obtained leave to challenge this finding). The Taxpayer's argument therefore proceeds on an incorrect factual premise.

41. Moreover, I do not agree that the mere execution of an agreement cannot by itself be a profit-making operation. Whether it is so in any particular case depends on the facts. Given that the Taxpayer's obligation under the Deed of Cooperation was essentially to grant sub-licences and that it was to receive the 40% Royalties thereunder, and that it was to receive the Upfront Payment on the signing of the Deed of Cooperation, I cannot agree that the Board was wrong to conclude that the Taxpayer's use of its rights under the Master Licence to enter into the Deed of Cooperation and the sub-licensing contracts in Hong Kong were the source of the Taxpayer's profits.

42. Mr Mariani cited *Lam Soon Trademark v CIR* [2004] 3 HKLRD 258, saying that since Tang J (as he then was) held that the taxpayer's profits in that case were sourced in Hong Kong because the relevant agreements were concluded in Hong Kong, albeit signed elsewhere, it follows that in the present case, where the facts are reversed

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[11] Taxpayer's skeleton paragraph 44; footnote 46.

(with the relevant agreements being signed in Hong Kong but concluded elsewhere), the Taxpayer's profits must be sourced outside Hong Kong. Leaving aside the incorrect factual premise (referred to above) of this argument, the authority simply does not establish any proposition of law that a taxpayer's source of profits turns on where agreements are concluded and not where they are signed.

43. Mr Mariani also cited *Thorpe Nominees Pty Ltd v FCT* (1988) 19 ATR 1834 for a similar purpose, it being held in that case that the fact that the relevant contract was signed in Switzerland was not an indication of the locality of the source of profits. Again, this is simply a decision on the facts; moreover, the facts were that Switzerland was chosen for "no particular reason" other than as part of a tax avoidance scheme (at 1842). There is therefore not even an analogy with the present case on the facts, where there were commercial reasons for establishing the Taxpayer in Hong Kong.

C3.3 Taxpayer and BLBG obliged to carry on the business in Japan jointly

44. The Taxpayer complains that the Board failed to take into account the fact that the Taxpayer and BLBG were contractually obliged to carry on the business of licensing the Trademarks in Japan jointly.

45. However, as Mr Mariani acknowledged, two taxpayers can participate together in one business, yet have their own respective profit-making activities. In the present case, the different obligations of the Taxpayer and BLBG were clearly set out in the Deed of Cooperation. It

was right, with respect, for the Board to only have regard to what the Taxpayer did to earn its profits.

C3.4 Board failed to place weight on the registration of the Trademarks in Japan

46. The Taxpayer says that the Board failed to attach due weight to the fact that the Trademarks were registered in Japan and that they were only exploitable in Japan, and that they had no existence as property until they were registered.

47. With respect, the Board rightly said (Decision at [130]) that the focus should be on the profit-producing activities of the Taxpayer and that the registration of the Trademarks in Japan was not such an activity. What the Taxpayer did to earn its profits was to use the Master Licence granted to it to enter into the Deed of Cooperation and the sub-licences in Hong Kong.

48. Mr Mariani submitted that profits from the exploitation of a trademark should in general be sourced in the jurisdiction where it is registered. However, no authority was cited in support of this proposition, other than "by analogy" with *Rhodesia Metals, Ltd v Commissioner of Taxes* [1940] AC 774, which concerned the very different situation of profits arising from the sale of immovable property outside the jurisdiction. This very analogy was rejected in *CIR v HK-TVB International* at 197 lines 21 to 32, Lord Jauncey observing that intellectual property rights [12]

[12] And without confining such observations to any particular type of intellectual property right, contrary to the suggestion in Taxpayer's skeleton paragraph 52.

exercisable only in one country are not to be equated with immovable property in that country.

49. As Mr Lam submitted, the Taxpayer's argument that since the Trademarks could only be exploited in Japan, profits from the sub-licensing thereof could only be sourced in Japan, was essentially the argument rejected in *CIR v HK-TVB International*. In that case, the taxpayer made profits from the granting of sub-licences to television operators outside Hong Kong. It was argued that the taxpayer exploited property assets by sub-licensing rights which were only capable of use in Vancouver. This was rejected. The proper approach was to ascertain what were the operations which produced the relevant profits and where those profits took place. In that case the relevant business of the taxpayer, carried on in Hong Kong, was the exploitation of film rights exercisable overseas. The fact that the rights were only exercisable overseas was irrelevant in the absence of any financial interest in the sub-licensee's subsequent exercise of those rights. See 196 line 43 to 198 line 21. With respect, the Board rightly adopted the same approach: Decision at [131].

C3.5 Board erred in relying on the input of Ricky Li of Hookedge UK

50. The Taxpayer says that the Board erred in relying on the input of Ricky Li in contract negotiations to anchor the operations of the Taxpayer to Hong Kong, since Mr Li's primary duty must have been to advance the interests of Hookedge UK.

51. However, the evidence, which the Board accepted, was that Ricky Li gave his comments for and on behalf of the Taxpayer. See Decision at [103] to [105].

C3.6 Tax position of Antares Cheng irrelevant to source of Taxpayer's profits

52. The Taxpayer says that there is not necessarily any correlation between (on the one hand) Antares Cheng's director's fee being tax deductible in Hong Kong and his paying salaries tax and (on the other hand) the Taxpayer carrying on the specific licensing operations that generated the 40% Royalties and the Upfront Payment in Hong Kong.

53. The Board referred to Mr Cheng's director's fee, and to Mr Cheng paying salaries tax in Hong Kong, in the context of the Taxpayer's argument that when Mr Cheng concluded the Deed of Cooperation and the sub-licences, he was doing so on behalf of Hookedge UK rather than the Taxpayer. The Board rejected this argument, noting that Mr Cheng's director's fee was claimed by the Taxpayer to have been incurred in the production of its profits in Hong Kong, and that Mr Cheng paid salaries tax in Hong Kong. See Decision at [111] to [115].

54. I do not see how this analysis can be faulted. The two matters are clearly relevant to the issue of whether Mr Cheng acted on behalf of Hookedge UK or the Taxpayer.

C3.7 Conclusion in relation to Ground 2

55. I therefore conclude that there is no merit in Ground 2.

D. GROUND 3: WHETHER BOARD ERRED IN HOLDING THAT UPFRONT PAYMENT WAS REVENUE, RATHER THAN CAPITAL, RECEIPT

56. This ground deals with the Taxpayer's alternative argument in relation to the Upfront Payment. The issue under this ground is whether the Upfront Payment was capital in nature and therefore not assessable to profits tax under s.14 IRO.

D1. The applicable principles

57. The Commissioner does not dispute that capital receipts are not assessable under s.14 IRO.

58. In considering whether a particular payment is of a capital or revenue nature, the approach to be adopted is the same no matter whether the payment is an item of receipt or expenditure: *Commissioner of Inland Revenue v Wattie* [1999] 1 WLR 873 at 880B (Lord Nolan, Privy Council).

59. However, it is wrong to assume exact congruence between the capital or revenue character of a sum as a receipt and its character as expenditure. A receipt may be income in the hands of the payee, whether or not it is an expenditure of a capital nature by the payer. Whether or not a particular receipt is income depends on its quality in the hands of the recipient. See *Federal Commissioner of Taxation v Montgomery* (1999) 198 CLR 639 at [98], [99] (Gaudron, Gummow, Kirby and Hayne JJ, High Court of Australia); cf. *China Mobile Hong Kong Company Limited v CIR* [2020] HKCFI 1649 at [51] (Chow J, as he then was) (a case regarding expenditure).

60. The relevant principles in determining whether a particular payment is capital or revenue in nature may be distilled from the *China Mobile Hong Kong Co Ltd v Commissioner of Inland Revenue* [2022] 5 HKLRD 666 at [26] to [29], a case regarding expenditure (Kwan VP); *IRC v John Lewis Properties plc* [2003] Ch 513 at [80] to [87], a case regarding receipts (Dyson LJ); *British Dyestuffs Corporation (Blackley), Ltd v The Commissioners of Inland Revenue* (1923) 12 TC 586 at 596, a case regarding receipts (Bankes LJ).

60.1 Whether a payment is capital or revenue in nature is a question of law, which must be answered in light of all the circumstances which it is reasonable to take into account, and the weight to be given to a particular circumstance in a particular case must depend on common sense rather than on a strict application of any single legal principle.

60.2 The question must be answered from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured employed or exhausted in the process.

60.3 Although there is no single decisive test, the courts have held that a number of factors may usefully be taken into account:

60.3.1 whether the payment is made once and for all, or is going to recur every year;

60.3.2 in the case of an item of expenditure, whether it is made with a view to bringing into existence an asset or advantage for the enduring benefit of a trade; a benefit is enduring for this purpose if it is of a

permanent quality or has sufficient durability, it does not have to be everlasting; length of time, although not a deciding factor, does in practice shed light on the nature of the advantage sought and the longer the duration, the greater the indication that a structural solution was being sought;

60.3.3 in the case of an item of expenditure, whether it relates to the cost of creating, acquiring or enlarging the permanent structure of which the income is to be the produce or fruit, or instead represents the cost of earning that income itself or performing the income-earning operations;

60.3.4 in the case of an item of receipt, whether the transaction is in substance a parting by the taxpayer with part of its property for a purchase price, or a method of trading by which it acquires the particular sum of money as part of the profits and gains of that trade;

60.3.5 the value of the asset assigned;

60.3.6 the fact that the payment causes a diminution in the value of the assignor's reversionary interest; and

60.3.7 whether the disposal of the asset is accompanied by a transfer of risk in relation to it.

D2. The Taxpayer's case

61. The Taxpayer's argument is that the Upfront Payment did not arise in the ordinary course of trade, having been paid prior to the commencement of the sublicensing business. Rather, it was a non-refundable payment made by BLBG to participate in the business and buy in to the Deed of Cooperation, and under the Deed of Cooperation, the Taxpayer parted with up to 60% of the economic benefit it would otherwise have derived under the Master Licence. Pursuant to the five factors considered in *IRC v. John Lewis*, the Upfront Payment was capital in nature. Furthermore, it was made in connection with the permanent, profit-making structure of the Taxpayer's business.

62. A number of these points consider the nature of the Upfront Payment as an item of expenditure made by BLBG, rather than the nature of the Upfront Payment as a receipt in the hands of the Taxpayer. However, it is the latter that is relevant for present purposes: *Federal Commissioner of Taxation v Montgomery*.

63. It is true that the Upfront Payment was a one-off, rather than ongoing, receipt, to cover the 3.5-year term of the Deed of Cooperation.

64. However, I do not agree with the Taxpayer that it transferred a portion of its economic and contractual rights regarding the Trademarks under the Master Licence to BLBG.[13] It did not transfer any of its rights under the Master Licence to BLBG. Nor was there any transfer of the Trademarks to BLBG (which in any event the Taxpayer did not own), as they were registered in Japan in the name of Hookedge UK: Decision at [140] to [141].

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[13] Taxpayer's skeleton paragraph 59.2.

65. Nor do I agree that the Taxpayer transferred to BLBG 60% of the economic benefit it would otherwise have derived under the Master Licence in return for the Upfront Payment, or that the Taxpayer suffered a temporary diminution in the value of its interest in the Master Licence to this extent in return for the Upfront Payment,[14] since:

65.1 in the first place, there is no factual basis for the assumption that the Taxpayer would have earnt the same amount in royalties with and without BLBG's participation (such that it can be concluded that with BLBG's participation, the Taxpayer would have earned 40% less than it would have done without BLBG's participation), and

65.2 in any event, BLBG had to perform all its other obligations under the Deed of Cooperation in order to earn its share of royalties, not just make the Upfront Payment. Furthermore, any right of exclusivity[15] was granted to BLBG in return for the provision of a corporate guarantee, not in return for the Upfront Payment: see cl.7.1 of the Deed of Cooperation.

66. There is therefore no analogy with *Van den Berghs, Limited v Clark* [1935] AC 431, in which the taxpayer received a payment for the destruction of its entire (contractual) profit-making apparatus; or with *Sabine (HM Inspector of Taxes) v Lookers, Ltd* (1958) 38 TC 120, in which the taxpayer received a payment for a material variation in its (contractual) profit-making apparatus.

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[14] Taxpayer's skeleton paragraph 59.3, 62.

[15] Cf. Taxpayer's skeleton paragraph 59.3.

67. Nor do I agree that these two authorities establish the proposition that if a contract forms part of a taxpayer's profit-making structure, and is not comprised in the taxpayer's stock-in-trade or otherwise a contract from which the taxpayer directly derives its ordinary trading profits, and the taxpayer receives a payment to constitute, vary, or terminate the contract, "then" the payment must be a capital sum.[16] The proposition is clearly too broad – it cannot be the case that any receipt of payment for the variation of a contract, however fundamental that contract is to a taxpayer's profit-making structure, must be capital in nature. Nor do the two authorities suggest this to be the case. The proposition is also contrary to the well-established approach laid down in the authorities of needing to consider the matter from a practical and business point of view, and to consider all the circumstances in each case rather than applying a rigid rule.

68. Whilst the Upfront Payment did mean that the Taxpayer received income before sublicensing contracts of Japanese sub-licensees were concluded, this does not mean that it was received before the Taxpayer commenced its business, or a condition precedent to the commencement of its business.[17] The Taxpayer had already commenced its business and, as earlier mentioned, was in a position, by virtue of its rights under the Master Licence, to earn profits by (inter alia) entering into the Deed of Cooperation (as the Board found). The Upfront Payment was part of those profits. In receiving the Upfront Payment, the Taxpayer was

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[16] Taxpayer's skeleton paragraph 65.

[17] Taxpayer's skeleton paragraph 58. This again depends on the submission that the Taxpayer conducted a separate business in respect of the Japanese sub-licences, which I have rejected.

not transferring any risk to BLBG, but rather, exploiting its rights for reward.

69. I respectfully agree with the Board's view that Upfront Payment arose in the course of the ordinary conduct of the Taxpayer's business (Decision at [138]). From a practical and business point of view, the Taxpayer received the Upfront Payment because it was in a position to exploit its rights under the Master Licence, not because it was giving up any asset or transferring any risk.

70. I therefore do not agree that the Board erred in rejecting the Taxpayer's submission that the Upfront Payment was capital in nature.

E. CONCLUSION; DISPOSITION

71. I dismiss the Taxpayer's appeal, and make an order *nisi* that the costs of and occasioned by these proceedings be paid by the Taxpayer to the Commissioner, to be taxed if not agreed.

(Yvonne Cheng)
Judge of the Court of First Instance
High Court

Mr Stefano Mariani, Solicitor Advocate of Baker & McKenzie, for the Appellant

Mr Julian Lam, instructed by Department of Justice, for the Respondent