

Hong Kong

High Court Rules that Profits of Interposed Hong Kong Company Are Not Taxable

6 May 2022

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In its [judgment](#) on 20 April 2022 in *Newfair Holdings Ltd. v. Commissioner of Inland Revenue*, the Court of First Instance of the Hong Kong High Court ruled that the profits of an interposed Hong Kong company did not have a Hong Kong source and are thus not subject to profits tax in Hong Kong.

(a) Facts. Newfair was incorporated in Hong Kong on 9 October 2013 and has been the wholly owned subsidiary of a Dutch company, VBZH, since 15 October 2013. The principal business carried on by the VBZH Group was the distribution in European markets of electronic products sourced from manufacturers in the Far East.

Before Newfair was established, merchandise was sent to VBABV (a member of the Group) directly from the suppliers. Soon after its incorporation, Newfair entered into a Master Purchase Agreement (as purchaser) with a supplier and a Master Sales Agreement (as seller) with VBABV (as purchaser), whereby VBABV would acquire exclusive European distribution rights to the merchandise. The interposition of Newfair between VBABV and the suppliers was to achieve fiscal efficiency as advised by the Group's tax advisors. Both agreements were negotiated, concluded and executed outside Hong Kong.

Newfair's registered office (HK Office) was the office of an accounting firm in Hong Kong. Newfair never physically operated at the HK Office and never engaged any employees, officers or agents in Hong Kong. All office work was done by the purchasing manager of VBABV. The only local asset Newfair owned was a Hong Kong bank account, which was used to pay the suppliers and receive all of the revenues.

The transactions that generated the profits of Newfair were the purchase of merchandise from the suppliers and the resale of the same at a 35% mark-up to VBABV. The purchase prices were determined through negotiations mainly between VBZH (specifically one of its shareholders) and the suppliers, and only outside Hong Kong, and once the transactions were agreed, the purchasing manager of VBABV would attend to the follow up work with the suppliers by email. All of the commercial operations relevant to the production of Newfair's profits were done outside Hong Kong.

Newfair was assessed to tax on the profits from the sale of merchandise to VBABV, and it appealed against the assessment. However, the Inland Revenue Board of Review found, in its decision dated 19 January 2021 ([Case No. D14/20](#)), that Newfair, being interposed between the Dutch purchaser and the suppliers, earned its profits by being an entity in Hong Kong with a Hong Kong bank account, and its profits were derived from Hong Kong.

(b) Issues. The issues before the Court were whether Newfair carried on a business in Hong Kong, and whether Newfair's profits of that business arose in or were derived from Hong Kong.

(c) Decision. The Court overturned the Board of Review's decision, holding that Newfair did not have a business in Hong Kong, the profits of which were offshore and did not arise from commercial operations in Hong Kong. Therefore, Newfair was not subject to profits tax in Hong Kong in the relevant years of assessment.

In coming to its decision, the Court agreed that the tax law imposes tax liability on what an entity does, and not what it is. The interposition of Newfair as an intermediary entity was not in itself a commercial operation that generated taxable profits, and the operation of the Hong Kong bank account was administrative in nature and could not amount to profit-producing operations. Among other notable factors, the fact that all the commercial operations relevant to the production of Newfair's profits were done outside Hong Kong, and that the contracts for sale and purchase of the merchandise were executed offshore, were relevant in determining that the profits did not have a Hong Kong source.

See also

[Hong Kong - Corporate Taxation - Country Surveys section 1.3.1.](#)

[Hong Kong - Country Analyses - Corporate Taxation section 1.2.1.1.](#)