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The Problem with the Dock Case

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*1 Commissioner of Inland Revenue v The Hong Kong and Whampoa Dock Co Ltd [1] (commonly and conveniently referred to as the 'Dock case') is one of the most important cases - perhaps the most important case - in Hong Kong tax law. As is well known, the case concerned the 'source' principle, upon which Hong Kong's tax system is based and in accordance with which s 14 of the Inland Revenue Ordinance confines the charge to profits tax to profits 'arising in or derived from Hong Kong.' The Dock case was only the second [2] ever reported Hong Kong case on source, and the first decision of the Full Court (predecessor to the Court of Appeal). In the four decades since the case was decided, it has been frequently cited and relied upon. Indeed, the courts, [3] writers of text books, [4] and other commentators [5] have routinely taken the Dock case as not merely correct, but as more or less axiomatic. Consequently, it is fair to say that the prevailing interpretation of the geographical scope of profits tax is squarely based upon this case. The aim of this article, however, is to suggest that the Dock case is at best profoundly misleading, if not simply wrong, in that the Full Court's reasoning, and perhaps also its decision, are contrary to what is perhaps binding [6] Privy Council authority.

*1 The problem with the Dock case is that the Full Court should have followed the decision of the Privy Council in the 1900 New South Wales case Commissioners of Taxation v Kirk, [7] but did not. Kirk's case established the basic principle that, in some circumstances, at least, source-based income tax legislation, such as Hong Kong's Inland Revenue Ordinance, [8] implicitly requires the 'apportionment' of profits derived [9] partly from within the taxing *60 jurisdiction and partly from outside it. In other words, according to Kirk's case, a profit derived partly from Hong Kong and partly from outside Hong Kong is taxable to the extent that it is derived from Hong Kong. Reece J (who delivered the leading judgment in the Dock case) accepted as a fact that the profit in question (which was produced by salvaging a ship outside Hong Kong and returning it to its owner in Hong Kong) was derived partly from Hong Kong and partly from outside Hong Kong. As a decision of the Privy Council, Kirk's case was (and perhaps remains) binding in Hong Kong. [10] Therefore, in the absence of any grounds upon which the case could be distinguished, Reece J should have followed it. He made no attempt to distinguish Kirk's case. Indeed, he purported to follow it. He should therefore have concluded that the Dock company's profit was taxable, but only in part. And yet he did not: rather, he concluded that it was not taxable at all.

*2 The reason appears to be that Reece J misunderstood Kirk's case. More specifically, he seems to have thought that the Privy Council in Kirk did not order apportionment. In other words, he seems to have missed the whole point of the case. Precisely how this misunderstanding came about is, of course, impossible to say, but it appears that Reece J may have been led astray by the ambiguously worded headnote with which the report of Kirk's case is encumbered. [11] This headnote is so deceptively worded that one wonders whether the person who wrote it understood the case; but that Reece J relied on the headnote seems clear from the fact that he incorporated virtually the whole of it in his own judgment. [12] But whether it was the headnote to Kirk's case which led Reece J astray, or the judgment [13] itself, or some other factor, the unfortunate point is that his reasoning seems plainly flawed.

*2 More unfortunate still is that the Dock case has been far more influential than its facts might suggest. Salvage, of course, is an economic activity of relatively little importance, but the Dock case seems to have been universally regarded in Hong Kong as establishing not only that the profits of salvage must be either taxable in full or not taxable at all, but that all profits, however produced, must be either taxable in full or not at all. That is, s 14 of the Inland Revenue Ordinance came to be interpreted as neither requiring nor permitting the apportionment of profits in any circumstances. In other words, the Dock case seems to have led Hong Kong's courts, Inland Revenue Department, and taxpaying community completely to ignore the rule in Kirk's case. Since Kirk's case was a decision of the Privy Council, this seems clearly to have been wrong. The error was partially corrected in the 1990 Hong Kong case Commissioner of Inland Revenue v Hang Seng Bank Ltd, [14] in which the Privy Council said that the *61 Inland Revenue Ordinance implicitly requires the apportionment of profits in some circumstances. This obliged the Inland Revenue Department to acknowledge that apportionment is at least theoretically possible, but the Department continued (and continues still) to maintain that apportionment will not have ‘a wide application.’ [15] In practice, this seems to mean that the Department almost invariably insists that profits are either taxable in full, or not at all. And, given that the Department is loath to accept that the profits of a business carried on in Hong Kong are not taxable at all, this, in turn, leads it almost invariably to insist that such profits are taxable in full. [16]

*3 The Department seems not to have offered any legal authority for this restrictive interpretation of the rule in Kirk's case, but it seems to be derived from Reece J's faulty reasoning in the Dock case. It is true that the scope of the rule in Kirk's case is debatable but, if (as I suggest) Reece J's reasoning in the Dock case is deficient, it is difficult to construct any basis upon which the Department's current position on apportionment can be supported. In other words, profits which are derived partly from Hong Kong and partly from outside Hong Kong and which are currently regarded (on the basis of the wrongly reasoned Dock case) as taxable in full, are actually (on the authority of the neglected Privy Council decision in Kirk's case), at least in some circumstances, taxable only in part. Given Hong Kong's role as a centre of international trade and finance, it is obviously common for Hong Kong firms to produce profits which could be said to be derived partly from Hong Kong and partly from outside Hong Kong. Rectifying Reece J's errors in the Dock case, and defining the scope of the rule in Kirk's case, are therefore matters of considerable consequence, both conceptual and practical.

*3 This article consists of five parts. In the first part, I review Kirk's case and its misleading headnote. In the second part, I examine some of the more important judgments in the series of subsequent cases in which the Privy Council, the High Court of Australia, and various other courts have considered the scope of the rule in Kirk's case. In particular, it is necessary to review Commissioner of Taxation (New South Wales) v Hillsdon Watts Ltd [17] because Reece J's erroneous reliance on this case was one of the factors which led him to misinterpret Kirk's case; and it is necessary to review some of the other cases in the series because there is no other way of satisfactorily explaining Hillsdon Watts. In the third part of the article, I examine the Dock case, focusing on Reece J's incorrect *62 interpretation of Kirk and on his erroneous reliance on Hillsdon Watts. In this part, I also suggest how the Dock case ought to have been decided. In the fourth part, I explain how the errors in the Dock case have been perpetuated and compounded in subsequent cases. Finally, in the fifth part, I return to the rule in Kirk's case, for the purpose of examining its scope. In other words, in this part, I discuss when Hong Kong's Inland Revenue Ordinance implicitly requires apportionment, and when it does not.

Kirk's case

*4 The taxpayers in Commissioners of Taxation v Kirk [18] were the large and well-known Australian mining company, Broken Hill Proprietary Co Ltd (‘BHP’), and one of its subsidiaries; the individual Kirk after whom the case is named was their representative. The two companies operated mines in New South Wales. They extracted ore from these mines and processed it so as to convert it into a merchantable product. The processing, like the extraction, took place in New South Wales. [19] The companies then sold the product at a profit. The sales were effected [20] by the companies' offices in Melbourne and London.

*4 The companies were assessed to tax on the whole of these profits under s 15 of the New South Wales Land and Income Tax Assessment Act 1895, which imposed tax on income ‘[a]rising ... from any ... source whatsoever in New South Wales.’ [21] Thus, the New South Wales Act, like Hong Kong's Inland Revenue Ordinance, was based on the source principle. That is, it sought to tax only domestic income, not offshore income. The New South Wales Act also resembled Hong Kong's Inland Revenue Ordinance in that it was silent as to *63 the possibility that a profit might be derived partly from within the taxing jurisdiction, and partly from outside it. That is, it made no express provision for how to deal with a profit arising partly from sources within New South Wales, and partly from sources outside New South Wales. There seem, however, to be two possible interpretations. First, s 15 might implicitly have required the apportionment of such profits. That is, s 15, properly interpreted, might in some circumstances have imposed tax on the profit in question to the extent that it was derived from New

South Wales. In other words, the part of the profit derived from New South Wales was taxable, and the part derived from outside New South Wales was not. Alternatively, s 15 might have required, in all cases, an 'all or nothing' interpretation. That is, it might have required that either the whole profit was taxable, or that none of it was.

*4 According to the interpretation of source-based income tax legislation prevailing at the time, a profit made on the sale of goods is derived entirely from the place where the sale is effected, irrespective of where and how the taxpayer acquired the goods. This was confirmed in Re Tindal, [22] in which the taxpayer produced goods in New South Wales and sold them in the United Kingdom. The Supreme Court of New South Wales held that the profit thereby produced was derived entirely from the United Kingdom, and that it was therefore not taxable at all in New South Wales.

*4 The assessments levied in Kirk's case thus constituted a direct challenge to the prevailing interpretation. It was argued on behalf of the commissioners, first, that the companies' profits arose entirely in Australia and that they were therefore taxable in full. In the alternative, counsel for the commissioners maintained that the companies' profits, if not taxable in full, were at least taxable in part. The Supreme Court of New South Wales rejected this challenge and confirmed the interpretation of the law which it had laid down in Re Tindal. That is, it held that the profits in question were derived, in their entirety, from sources outside New South Wales and that they were therefore not taxable at all. [23] The Privy Council, however, accepted the alternative interpretation proposed on behalf of the commissioners. That is, the Privy Council held, first, that the profits had arisen partly in New South Wales (where the ore was extracted from the ground and processed) and partly outside New South Wales (where the contracts of sale were effected) and, second, that the statute therefore implicitly required the apportionment of the profits. In other words, the part of the profit attributable to the extraction and processing of the ore in New South Wales was taxable, but the part attributable to the making of sales outside New South Wales was not.

*5 Kirk's case thus established the principle that a profit made by manufacturing goods in one jurisdiction and selling them in another is derived partly from *64 each, and that apportionment is therefore required. [24] It is precisely because the case established this principle that it is important. This is not at all apparent from the headnote, however, which is worded, in full, as follows:

*5 Where income was in part derived from the extraction of ore from the soil of New South Wales Colony, and from the conversion in the latter Colony of the crude ore into a merchantable product:

*5 Held, that this income was assessable under the New South Wales Land and Income Tax Act of 1895, s15, sub-ss 3, 4, notwithstanding that the finished products were sold exclusively outside the Colony.

*5 In re Tindal, (1897) 18 NSWLR 378, overruled. [25]

*5 This is ambiguous. The headnote states that 'this income was assessable,' but it is unclear whether 'this income' means the whole of the income, or only the part of it which was derived from New South Wales. If the writer of the headnote (one Herbert Cowell) intended the former meaning, he was simply wrong, for that is not what the Privy Council decided. If he intended the latter meaning, he was not exactly wrong, but he did nonetheless fail to communicate the basic point of the case. In the Dock case, Reece J seems to have interpreted this headnote (which he recited in full, [26] except for the last line) as meaning that the whole profit was taxable and, therefore, that apportionment was not required. But, as I have explained, the whole point of Kirk's case is that the Privy Council held that apportionment was required. [27]

*5 The confusion is not wholly attributable to the writer of the headnote. Kirk's case came before the Privy Council by way of the 'case stated' procedure; and the case stated by the court of first instance for the appellate courts was formulated as follows:

*5 *65 (a) Had the company [28] any income in 1897 within the meaning and operation of the Land and Income Tax Assessment Act of 1895, and liable to taxation under the provisions of that Act?

*5 (b) Did the judgment in In re Tindal [29] govern this case? [30]

*5 The Privy Council's judgment (which was delivered by Lord Davey) is principally devoted to explaining that the Supreme Court of New South Wales had been wrong to conclude that the whole of the taxpayers' profits had arisen outside New South Wales; that, on the contrary, part of their profits had arisen in New South Wales; and that this part was taxable. Having explained that this was so, however, Lord Davey concluded in the following terms: 'Their Lordships are, therefore, of opinion that the first question stated in the special case on each of these appeals should have been answered in the affirmative, and that is all they are called upon to say.' [31] In other words, the stated case required the Privy Council to decide only whether any part of the taxpayers' income was taxable; it did not require a decision as to how much of the profit was taxable. [32] It would have been helpful if the Judicial Committee had answered this second question also but, as Lord Davey said, it was not called upon to do so. Some of the blame can perhaps be attributed to those who drafted the case; had they asked the court to rule as to the extent to which, if at all, the taxpayers' profits were taxable, a century's confusion might have been avoided at the outset. [33]

Subsequent cases on source and apportionment

*6 Kirk's case seems to have been the first Privy Council decision on source. It established the basic rule that, at least in some circumstances, source-based income tax legislation of the kind which was usual throughout the British Empire [34] in the early years of the twentieth century (and which is still in force *66 in Hong Kong [35]) implicitly requires the apportionment of profits derived partly from within the taxing jurisdiction and partly from outside it. Given the prevalence of such legislation, and given that the rule in Kirk's case is obviously fundamental to its interpretation, it is not surprising that there followed a series of cases on the source principle generally [36] and on the scope of the rule in Kirk's case in particular. [37] In order to expose Reece J's errors in the Dock case, however, it is necessary to refer to only a small number of them. [38]

*6 For present purposes, the most important of these cases are the decisions of the Privy Council [39] in Lovell & Christmas Ltd v Commissioner 67of Taxes, [40] International Harvester Co of Canada Ltd v Provincial Tax Commission, [41] and Provincial Treasurer of Manitoba v Wm Wrigley Jr Co Ltd. [42] These decisions, although of binding authority in Hong Kong, seem to have been generally ignored in the territory, perhaps as a consequence of Reece J's reasoning in the Dock case. In Lovell & Christmas v Commissioner of Taxes, [43] the taxpayer carried on business in England. It had one employee who was resident in New Zealand and another who visited New Zealand annually. The function of these employees was to make arrangements with New Zealand dairy manufacturers whereby the taxpayer would sell their produce in England. Pursuant to these arrangements, the manufacturers sent their butter and cheese on consignment to the taxpayer in England. The taxpayer sold it, withheld an agreed commission, and remitted the balance to the manufacturers. The Privy Council held that the taxpayer's profit was derived entirely from the United Kingdom and that it was therefore not taxable in New Zealand at all. Sir Arthur Wilson (delivering the judgment of the Privy Council) explained:

*6 The moneys received by the [taxpayer], out of which they deduct their commission, and from which, therefore, their profits come, are paid to them under the contract of sale effected in London. The earlier arrangements entered into in New Zealand appear to their Lordships to be transactions the object and effect of which is to bring goods from New Zealand within the net of the business which is to yield a profit. To make those transactions a ground for taxing, in New Zealand, the profits actually realized in London would, in their Lordships' opinion, be to extend the area of taxation further than the authorities warrant. [44]

*7 The decision seems to confirm that a profit made by selling goods is generally derived from the place where the goods are sold, but the judgment is unsatisfactory insofar as the Privy Council did not explain why the rule in Kirk's case did not apply. That is, the Privy Council did not explain why apportionment was not required. Indeed, the Privy Council did not mention Kirk's case, or the possibility of apportionment, at all.

*7 In International Harvester Co of Canada Ltd v Provincial Tax Commission [45] the taxpayer manufactured goods in Ontario and sold them in Saskatchewan. It was assessed to tax in Saskatchewan, under income tax legislation based on the source principle, on the whole of the profit thereby produced. The Privy *68 Council followed its own earlier decision in Kirk, and held that apportionment was required. The decision simply confirms that, in the half-century which had elapsed since Kirk's case, nothing had changed. The facts of Provincial Treasurer of Manitoba v Wm Wrigley Jr Co Ltd [46] were similar. The taxpayer manufactured chewing gum in Ontario and sold it in Manitoba. Again, the Privy Council held that apportionment was required. These cases confirm that the rule in Kirk's case is not confined to the particular New South Wales statute there in issue but, rather, that it applies to source-based income tax legislation generally. Also, in the International Harvester case, the Privy Council endorsed wholesale value as a basis for calculating apportionment. But these cases otherwise provide little guidance as to when apportionment is required, and when it is not.

*7 Also important is a series of decisions of the High Court of Australia in which the scope of the rule in Kirk's case was considered. [47] In Mount Morgan Gold Mining Co Ltd v Commissioner of Taxation (Queensland) [48] the facts were complicated but essentially involved mining gold in Queensland and selling it outside Queensland. By a majority, the court held that apportionment was necessary. The facts of Dickson v Commissioner of Taxation (New South Wales) [49] were substantially identical. Again, by a majority, the High Court ordered apportionment. In Commissioner of Taxation of Western Australia v D & W Murray Ltd [50] the taxpayer purchased goods in the United Kingdom and sold them in Western Australia. The taxpayer claimed, on the basis of Kirk's case, that Western Australia's source-based income tax legislation implicitly required the apportionment of the profit thereby produced, but the court (combined judgment of Knox CJ and Rich and Dixon JJ) held that the profit was entirely sourced in Western Australia and, therefore, taxable in full in that state. Like Lovell & Christmas v Commissioner of Taxes, [51] the Murray case thus confirmed that a profit made by buying and selling goods is generally derived from the place where the goods are sold. Unlike the Lovell & Christmas case, however, the Murray case offered an explanation for why apportionment was not required:

*8 *69 [This] case is not one in which operations in one place have produced a merchantable commodity, or have given or added value to things, marketed in another. In such cases value or wealth has been produced or increased and is contained in disposable assets. In other words, unrealized profits exist in the territory whence they are transported for the purpose of sale. In the case now to be decided, the [taxpayer's] business operations conducted in England by its head office consisted only in buying. They neither gave nor added value to the things which were purchased. There were no unrealized profits brought into existence, and contained in the goods when exported from England. [52]

*8 The calculation of apportionment on the basis of added value was discussed further in Federal Commissioner of Taxation v W Angliss and Co Pty Ltd, [53] in which the taxpayer dealt in meat and tallow. It produced the meat, and some of the tallow, itself in New South Wales. The rest of the tallow it purchased from other suppliers in New South Wales. The taxpayer sold all the meat and all the tallow in the United Kingdom. Sales were effected by a branch office in London. The High Court of Australia held that the source of the entire profit thereby produced was the United Kingdom, where the goods were sold, and that therefore no tax was payable in Australia. The distinction between this case and the other similar cases in which the courts had ordered apportionment [54] was that the meat and tallow could not have been sold at a profit in Australia. The meat consisted of substandard carcasses and offal. There was no market at all for these products in Australia, but they were saleable in the United Kingdom, because of the unusual state of the market brought about by the war (the profits in question having been made in 1918 and 1919). Similarly, although the taxpayer had sold its tallow at a profit in the United Kingdom, it could not have done so in Australia. The reason, again, was that the value of the tallow in Australia was no more than it had cost the taxpayer to produce or to purchase. Dixon J (with whom Rich and McTiernan JJ concurred; Starke and Evatt JJ dissenting) began by explaining the circumstances in which apportionment was required:

*8 [It is necessary to recognise] that production of itself may create profit and that sale may be no more than the conversion of profit into money: the *70 realization of a profit already contained in the goods. What is true of production is doubtless true also of other operations in connection with commodities. By the treatment or preparation of goods, indeed, possibly by their mere purchase at a low price, a gain may be obtained in one place before they are shipped or sold in another. [55]

*8 Having set out these principles, Dixon J proceeded to apply them to the facts of the case:

*9 The application of these principles reduces the question of most importance in the present case to one of fact, namely, what amount of the moneys realized by the sale of the goods in the United Kingdom represented value in exchange or money's-worth which existed in Australia independently of the extraterritorial operations of the taxpayer? [56]

*9 His answer to this question was that in Australia the meat had had no value beyond the cost of its production and the tallow had had no value beyond what the taxpayer had paid for it. Thus, according to Dixon J, the entire profit had its source in the United Kingdom and apportionment was therefore not required.

*9 W Angliss & Co therefore stands for two main propositions. First, apportionment is not invariably required when the taxpayer has manufactured goods in one jurisdiction and sold them in another, but only when it has added value in both jurisdictions. Second, the rule in Kirk's case is not confined to manufacturers. Rather, apportionment is required of a profit made by buying and selling goods, if the taxpayer purchases the goods 'at a low price.' [57] By this Dixon J seems to have meant a lower price than the price at which the taxpayer could have sold the goods in the place where it purchased them. In other words, if the taxpayer could have sold the goods at a profit in the place where it purchased them, then apportionment is required; and the amount of profit which the taxpayer would have made, had it sold the goods in the place where it purchased them, is to be attributed to that place.

*9 Finally, it is necessary to mention Commissioner of Taxation (New South Wales) v Hillsdon Watts Ltd, [58] because Reece J's misplaced reliance on a passage from the judgment of Dixon J in this case was central to his flawed reasoning in the Dock case. Like Angliss, Hillsdon Watts involved both manufacturing profits and trading profits. The taxpayer carried on in New South Wales a business of exporting plants and seeds. Some of the plants and seeds it produced *71 itself; the rest it purchased from other suppliers. The High Court of Australia unanimously held that apportionment was required of both categories of profits. Hillsdon Watts differs from the other cases mentioned in this article, however, in that the legislation under which the taxpayer had been assessed expressly [59] required the apportionment of profits derived partly from the taxing jurisdiction (New South Wales) and partly from elsewhere. This express requirement was provided for by s 28 of the New South Wales Income Tax (Management) Act 1928. [60]

*9 Although all five members of the court (Latham CJ, Rich, Dixon, Evatt, and McTiernan JJ) held that apportionment was required, four of them (all but Dixon J) seem to have attached very little, if any, significance to s 28. Rather, they appear to have thought (on the basis of Kirk's case and the various subsequent cases in which the rule in Kirk's case had been applied, considered, and refined [61]) that the statute would have implicitly required apportionment of the profits in question, even in the absence of s 28. In other words, they seem to have regarded s 28 as merely expressing a requirement which would in any event have been implicit. For example, Latham CJ based his decision on the following proposition:

*10 It has long been recognised that these provisions [in source-based income tax legislation], apart altogether from any statutory provisions requiring apportionment, impose a tax not upon the whole income if any part thereof is derived from the source mentioned, but only upon the part of the income shown to be so derived. This was decided in Commissioners of Taxation v Kirk very soon after the introduction of income tax in Australia. [62]

*10 That this approach effectively rendered s 28 redundant seems not to have troubled any of the court's members except for Dixon J, who attempted to salvage some purpose for it by suggesting that it would require the apportionment of profits in circumstances in which, in its absence, apportionment would not have been implicitly required by the rule in Kirk's case. This analysis, in turn, required Dixon J to suggest that there are types of profit which do not lend themselves to apportionment; and that, notwithstanding Kirk's case, in the *72 absence of legislation specifically requiring apportionment it would be necessary to regard such a profit as either taxable in full or not taxable at all. [63] But Dixon J's views as to the circumstances in which apportionment is implicitly required by statutes other the one with which he was concerned in the case before him were, obviously, obiter. Moreover, they were not endorsed by any of the other members of the court. They were to prove crucial in Hong Kong, however, for, as will be seen, they were to form the basis for Reece J's flawed analysis in the Dock case.

The Dock case

*10 The taxpayer in the Dock case [64] carried on business in Hong Kong as, among other things, a salvager of ships. It was contacted by the owner of a ship (the Bintang) which had run aground on a reef at the Paracel Islands. [65] The ship was stuck on the reef and damaged. The owner asked the taxpayer to repair the ship, re-float it, and tow it to Hong Kong. The taxpayer did not immediately commit itself as to whether it would attempt what the owner had requested, but it did dispatch a tug to investigate. On board the tug, in addition to its regular complement, was the Dock company's salvage officer. Upon arrival at the Paracels he inspected the stranded ship and decided it was salvageable. An agreement was thereupon entered into, at the Paracels, between the taxpayer (represented by its salvage officer) and the ship-owner (represented by the master of the Bintang) whereby the taxpayer agreed to attempt to salvage the ship and the owner agreed to pay, if the taxpayer succeeded. The attempt was indeed successful: the taxpayer repaired the ship, re-floated it, and towed it back to Hong Kong; and the owner duly paid. According to the Commissioner of Inland Revenue, the profit realised by the taxpayer on this endeavour was derived in its entirety from Hong Kong. Therefore, according to the Commissioner, the profit was taxable in full. The taxpayer appealed and, ultimately, [66] the Full Court (the leading judgment was given by Reece J, with whom Blair-Kerr and Macfee JJ simply concurred) held that the profit had been derived entirely from outside Hong Kong and that it was therefore not taxable at all.

*11 The problem with the Dock case is Reece J's reasoning and, in particular, the way in which he dealt with the possibility of apportionment. Like the statute in Kirk's case (the New South Wales Land and Income Tax Assessment Act *73 1895), Hong Kong's Inland Revenue Ordinance was (and remains) silent as to the possibility of apportionment. That is, it makes no mention of the possibility that a profit might be derived partly from Hong Kong, and partly from outside Hong Kong. As in the case of the New South Wales Act, however, there seem to be only two possible interpretations. First, s 14 might implicitly require the apportionment of profits in some circumstances. That is, s 14, properly interpreted, might in some circumstances impose tax on the profit in question to the extent that it is derived from Hong Kong. In other words, the part of the profit derived from Hong Kong is taxable, and the part derived from outside Hong Kong is not. Alternatively, s 14 might require, in all cases, an 'all or nothing' interpretation. That is, it might require that either the whole profit is taxable, or that none of it is.

*11 The services provided by the Dock company to the owner of the Bintang were performed partly outside Hong Kong (where the Bintang was re-floated and towed through international waters) and partly in Hong Kong (where the Bintang was towed through Hong Kong waters and returned to its owner). Reece J therefore accepted as a fact that the Dock company's profit was derived partly from Hong Kong and partly from outside Hong Kong. [67] Since the Privy Council's decision in Kirk's case was binding on him, [68] he should therefore have held that apportionment was required. [69] That is, he should have held that the part of the profit derived from Hong Kong was taxable, and that the part derived from outside Hong Kong was not.

*11 Of course, Kirk's case itself was concerned with manufacturing, not salvage, but it is difficult to conceive of any principled basis upon which it could be said that the rule in Kirk's case does not apply to a profit made by performing services partly within the jurisdiction and partly outside it. Indeed, it seems nowadays to be universally agreed that a profit produced by means of providing services *74 is derived from the place where the services are performed [70] and, therefore, that the Inland Revenue Ordinance implicitly requires the apportionment of a profit made by providing services both within and outside Hong Kong. This is the position of the Inland Revenue Department [71] and it is not controversial. [72] That the rule in Kirk's case applies in services cases is illustrated by Commissioner of Taxation v Cam & Sons Ltd, [73] a case concerned with the source of wages paid to men employed on fishing trawlers which sailed from New South Wales but spent most of their time, and caught most of their fish, outside New South Wales waters. It was held that apportionment was required. But, in any event, Reece J made no attempt to distinguish Kirk's case, either on the basis that it applies only to manufacturers or on any other ground. On the contrary, Reece J seems to have thought that he was following Kirk's case. It is possible also that the rule in Kirk's case is subject to a de minimis exception, [74] or to some other limitation; and that for this reason Reece J was right to conclude that the Inland Revenue Ordinance did not implicitly require the apportionment of the Dock company's profit. But this was not suggested by Reece J, either. Rather, as I have said, Reece J seems to have thought he was following Kirk's case.

*12 Exactly how the apportionment of the Dock company's profit should have been calculated is debatable, but valuing the different stages of the services provided by the Dock company, and then apportioning the company's profit on the basis of these values, would appear to be an exercise of no particular difficulty. No doubt there is scope for differences of opinion as to precisely how large a part of the profit should have been attributed to each stage, but that is so of virtually all cases in which apportionment might be required. [75] It is worth noting, in particular, that calculating apportionment in services cases (such as the Dock case) would appear to present considerably less difficulty than in manufacturing cases of the kind in which the Privy Council has ordered apportionment. [76]

*12 But Reece J did not apply the principle established in Kirk's case. Instead, he held that the Dock company's profit was not apportionable. That is, he held *75 that it must be either taxable in full, or not taxable at all. And, having allowed himself only these two options, he held that it was not taxable at all. On the assumption that the Inland Revenue Ordinance did not implicitly require the apportionment of the profit in question, this may well have been the correct decision. The assumption is difficult to reconcilable with Kirk's case however and, therefore, apparently [77] wrong. But, whether his conclusion was correct or not, the reasoning by which he reached it seems plainly to be flawed.

*12 In reaching the conclusion that the Inland Revenue Ordinance did not require the apportionment of the Dock company's profit, Reece J relied principally on the following passage from the judgment of Dixon J in Commissioner of Taxation (New South Wales) v Hillsdon Watts Ltd:

*12 In the absence of [a statutory provision expressly requiring apportionment], when a single profit is recovered as a result of operations which extend beyond the political boundary of the taxing state, the profit must be considered as arising on one side of the boundary rather than the other. If it is possible to ascertain how much of the profit is obtained although in an unrealized form at successive stages of the operations, the sum realized may be dissected and separate parts of it attributed accordingly to the places where the respective stages of the operations are completed. If this cannot be done and the total profit recovered is an inseparable whole obtained as the indiscriminate result of the entirety of the operations, the locality where it arises must be determined by considerations which fasten upon the acts more immediately responsible for the receipt of the profit. (See Commissioner of Taxation v D & W Murray Ltd (1929) 42 CLR 332; Federal Commissioner of Taxation v W Angliss & Co Pty Ltd (1931) 46 CLR 417.) [78]

*13 Reece J did not explain why he chose to rely on this particular passage, or even why he chose to rely on this particular case. But his reliance seems misplaced, for three main reasons. First, it is not clear that Dixon J was correct, as a matter of Australian law, to posit the existence of categories of profit which are not apportionable, except where apportionment is expressly required by the legislation. There seems to be very little authority on this point and so whether Dixon J was correct or not is debatable. In other words, Kirk's case, properly *76 interpreted, might require apportionment of all profits derived partly from within the taxing jurisdiction and partly from outside it, Dixon J's dictum notwithstanding. [79] The court in Hillsdon Watts was comprised of five judges, each of whom delivered his own judgment. All five came to the same conclusion (that apportionment was required), but none of the other four (Latham CJ, Rich, Evatt, and McTiernan JJ) endorsed Dixon J's view that a profit might be derived partly from within the taxing jurisdiction and partly from outside it and yet not require apportionment. Therefore, assuming that Reece J was justified in relying on Hillsdon Watts at all, his analysis of the case should have focused on the views of the majority, not on those peculiar to Dixon J. Moreover, Dixon J's conclusion in Hillsdon Watts was that apportionment was required. His suggestion that other profits, assessed to tax under other statutes, [80] in other cases, might not be apportionable was, therefore, obiter.

*13 Second, even if Dixon J was correct, as a matter of Australian law, in stating that there are categories of profit to which the rule in Kirk's case does not apply, it does not necessarily follow that the law of Hong Kong is the same as the law of Australia in this respect. The reason is simply that Dixon J's analysis in Hillsdon Watts seems not to be based on any decision of the Privy Council, nor to have been endorsed by the Privy Council in any subsequent case. [81] In other words, Reece J's consideration of apportionment should have been guided principally by the binding decisions of the Privy Council in Kirk's case, the International Harvester case, [82] and the Wrigley case, [83] rather than by the merely persuasive decisions of the Australian courts.

*13 Third, even if Dixon J's analysis is sound, and even if it holds in Hong Kong, Reece J should not have regarded it as applicable in the Dock case. Dixon J was bound by Kirk's case, in which the Privy Council established that in some circumstances, at least, source-based income tax legislation implicitly requires the apportionment of profits derived partly from the taxing jurisdiction and partly from outside it. But, according to Dixon J, there are exceptions to this rule. In other words, according to Dixon J, there are categories of profits which must be regarded as 'inseparable,' and which cannot be apportioned; and which must, therefore, be either taxable in full or not taxable at all, even if derived partly from the taxing jurisdiction and partly from elsewhere. It is unclear which kinds of profits Dixon J thought might be covered by his dictum, because he gave no examples. Perhaps he had in mind forms of income such as interest, *77 the apportionment of which might indeed present difficulties. [84] What does seem plain, however, is that, if Dixon J's dictum is correct at all, it does not apply to profits made by providing services.

*14 In the Dock case, Reece J held that the taxpayer's profit was not susceptible to apportionment, that it 'must be said to arise outside of Hong Kong rather than inside,' [85] and that it was therefore not taxable at all. His reasoning seems to have been essentially that it was impossible to dissect the taxpayer's profit because the facts of the case afforded no basis upon which separate parts of the profit could be attributed to the places where the taxpayer had undertaken the various stages of the operations which had produced the profit. Consequently, he regarded the 'total profit' as 'an inseparable whole obtained as the indiscriminate result of the entirety of the [taxpayer's] operations.'

[86] But, even assuming that Dixon J was correct in postulating the existence of categories of profits which are 'inseparable,' [87] Reece J seems clearly to have been wrong to treat the profit in question in the Dock case as of this kind. The reason is that it would seem to have been not only possible but relatively straightforward (adopting the words of Dixon J) 'to ascertain how much of the profit is obtained although in an unrealized form at successive stages of the [taxpayer's] operations.' In particular, there seems to be no reason for regarding the Dock company's profit as any more 'inseparable' than the profits which were ordered to be apportioned in the three binding Privy Council decisions [88] and by various other courts in various other cases. [89] On the contrary, it seems likely that a profit made by supplying services will be more easily apportioned than a profit made by manufacturing and selling goods. [90]

*14 In any event, Reece J proceeded on the apparently erroneous basis that either the whole profit was taxable, or none of it was. Having allowed himself only these two alternatives, however, he was troubled by Dixon J's proposition that, in cases in which apportionment is impossible, the source of the profit must be determined by reference to 'the acts more immediately responsible for the receipt of the profit.' [91] The contract between the Dock company and the owner of the Bintang provided for 'no cure - no pay.' [92] That is, the Dock company was not entitled to payment at all until it completed the salvage and returned the ship to its owner in Hong Kong. The act 'more immediately *78 responsible for the receipt of the profit' would thus appear to have been the return of the ship to its owner. This analysis leads to the conclusion that the profit was entirely derived from Hong Kong, since that was where the ship was returned to its owner.

*14 In order to avoid this conclusion, however, Reece J turned to Kirk's case. His analysis of Kirk begins with the headnote, virtually [93] the whole of which he recited verbatim (and which I have quoted in full at note 25). But as I have explained, this headnote is ambiguous and deceptively-worded. It makes no mention of apportionment. Rather, it seems to suggest that the profit in question was held to be taxable in full, and that apportionment was not required; and that, it seems, is what Reece J took it to mean. In any event, whether misled by the headnote, or by the judgment itself, Reece J seems to have thought that the Privy Council in Kirk held that apportionment was not required. But as I have explained, the whole point of Kirk's case is that apportionment was required.

*15 After reciting the headnote, Reece J adopted the following passage from the judgment itself:

*15 The fallacy of the judgment of the Supreme Court [of New South Wales] in this and in Tindal's case [94] is in leaving out of sight the initial stages, and fastening their attention exclusively on the final stage in the production of the income. [95]

*15 And the following statement from the judgment of Latham CJ in Hillsdon Watts:

*15 Income which is received by a person may be the result of a whole series of operations [96] conducted in different countries. When it becomes necessary to determine what are the sources of income it is a mistake to concentrate attention on 'the final stage' [97] in the operations which actually brings in the money which constitutes the gross income. [98]

*15 Reece J took these passages as authority for not regarding 'the final stage' of the Dock company's operations as necessarily decisive. This, in turn, freed him to focus on the fact 'that substantially the whole of the salvage operations, *79 excluding the short tow in the Colony waters which terminated the salvage, took place outside the Colony.' [99] And so, on this basis, Reece J concluded that the whole of the profit had been derived from outside Hong Kong and that it was therefore not taxable at all.

*15 The problem with this, of course, is that in both Kirk's case and Hillsdon Watts it was held that apportionment was required. When Lord Davey said in Kirk that it is a fallacy to fasten attention 'exclusively on the final stage' of the taxpayer's operations, he did not mean (as Reece J seems to have taken him to mean) that the final stage can be disregarded altogether. Rather, what Lord Davey intended is that attention should be fastened on the whole of the taxpayer's operations, and that a part of the profit should be attributed to each stage in the series of which the whole is comprised. Similarly, when Latham CJ in Hillsdon Watts said that 'it is a mistake to concentrate attention on the "final stage,"' he clearly did not mean that the final stage should be completely ignored. Rather, like Lord Davey in Kirk, he meant that a part of the profit should be attributed to each stage in the series of operations which produced the profit.

*15 Thus, Reece J's basic error was not to follow Kirk's case. This case, properly interpreted, required apportionment of the Dock company's profit. [100] Since Kirk's case was a decision of the Privy Council, Reece J was bound to come to this conclusion, but did not. Instead, he based his decision on Dixon J's obiter dictum in Hillsdon Watts to the effect that some profits are not susceptible to apportionment. But, even if it is assumed that Dixon J was correct (that is, even if it is assumed that there is such a thing as a profit which is derived partly from within the taxing jurisdiction and partly outside it, and yet which is not required to be apportioned), there seems to be no reason for regarding the Dock company's profit as being of this kind, and Reece J offered none.

The perpetuation and compounding of the error

*16 Salvage is a relatively unimportant form of economic activity. Had the Dock case been confined to its facts, its effect would have been correspondingly insignificant; but it was not. On the contrary, it was to prove extremely influential. [101] Indeed, the currently prevailing interpretation of s 14 of the Inland Revenue Ordinance seems to be squarely based on it. First, the Dock case confirmed that it is possible, as a matter of law, for a firm to carry on business in Hong Kong, and nowhere else, and yet to derive part of its profit, or even all *80 of its profit, from outside Hong Kong. In other words, the case established that the profits of a Hong Kong firm are not necessarily taxable in Hong Kong, even if the firm has no branch office in any other jurisdiction and even if it is obviously not liable to tax in any other jurisdiction. In this respect, the case is both correct [102] and fundamentally important.

*16 But, according to the Inland Revenue Department, although it is possible for a Hong Kong firm without a permanent establishment outside Hong Kong to derive profit from outside Hong Kong, it is only in ‘rare cases' that this will be so. [103] This position is based on a statement to this effect in the Privy Council's decision in the Hong Kong case Commissioner of Inland Revenue v HK-TVB International Ltd, [104] but it seems probable that its real source was the Dock case (which was cited by the Privy Council in HK-TVB International as one such ‘rare case' [105]), because it happened to concern salvage, rather than some more common form of commercial endeavour, such as trading or manufacturing. But this ‘rare case' dictum is misleading, for it is misconceived to infer the frequency with which a phenomenon occurs in the real world from the frequency with which it appears in the law reports. The number of firms deriving profits from outside Hong Kong has actually always been substantial, but the overwhelming majority of these firms have not appeared in the law reports for the simple reason that the Inland Revenue Department has accepted, correctly, that their profits are not subject to tax. [106] Moreover, once it is accepted that a profit escapes tax if the taxpayer organises his business in a certain way, [107] this particular mode of organisation will obviously tend to become less rare, because other firms are likely to copy it so that they, too, can escape tax.

*16 The Department's current position on apportionment is as follows: ‘Although the Department accepts that apportionment is permissible [108] under the *81 Inland Revenue Ordinance, it does not consider that it will have a wide application.' [109] The Department seems to have offered no legal justification for this restrictive premise as to the circumstances in which s 14 requires the apportionment of profits but, again, it seems to be based on the Dock case [110] and, again, it seems to be wrong. The scope of the rule in Kirk's case may be debatable, but even the narrowest plausible interpretation (that the rule is confined to manufacturers of goods and providers of services [111]) seems irreconcilable with the Department's proposition that apportionment will not ‘have a wide application.'

*17 The premise that apportionment will not have ‘a wide application' is fundamental to the Department's approach to the taxation of the profits of virtually all firms other than those whose activities are strictly confined to Hong Kong. The reason is that this premise leads the Department to maintain almost invariably [112] that a Hong Kong firm's profit must be either taxable in full, or not taxable at all. Moreover, the Department is loath to accept that a profit made by a firm carrying on business in Hong Kong and without a permanent establishment anywhere else is not taxable at all. Consequently, the Department's premise that apportionment will not have a wide application leads it ultimately to maintain almost invariably that the profits of a firm carrying on business in Hong Kong must be taxable in full, unless it has a permanent establishment outside Hong Kong to which part, or all, of the profits can properly be attributed. In other words, Reece J's erroneously restrictive conclusions as to apportionment are fundamental to the misleading ‘rare case' doctrine.

*17 Perhaps the most important consequences of the Department's restrictive position on apportionment are its positions on manufacturing profits (that is, profits made by manufacturing and selling goods) and trading profits (profits made by buying and selling goods). According to the Department, manufacturing profits are derived entirely from the place where the manufacturing takes place. Consequently, the Department rejects categorically the possibility that the Inland Revenue

Ordinance might implicitly require the apportionment of profits made by manufacturing goods in Hong Kong and selling them elsewhere. According to the Department, such profits are entirely attributable to the manufacturing. Therefore, they are taxable in full, [113] irrespective of offshore marketing activities. [114] This interpretation is obviously and directly contrary *82 to the Privy Council decisions in Kirk, [115] International Harvester Co, [116] and Wrigley, [117] to every case in the series decided by the High Court of Australia, [118] and to various other Australian and New Zealand cases. [119]

*17 The Department seems not to have offered any legal reason for disregarding these cases, but it seems likely that the source of its restrictive position as to apportionment is the Dock case. But Reece J's rejection of apportionment in the Dock case was based on Kirk and Hillsdon Watts and, as I have explained, Reece J seems to have misinterpreted both cases. That the Department's current position (that a profit made by manufacturing goods in Hong Kong and selling them elsewhere is derived entirely from Hong Kong and, therefore, taxable in full) seems to be derived (via the Dock case) from Kirk and Hillsdon Watts is particularly ironic, given that both Kirk and Hillsdon Watts concerned profits made by manufacturing goods in one jurisdiction and selling them in another and that, in both cases, it was held that apportionment was required. [120]

*18 The Department's position on trading profits seems even more seriously flawed. According to the Department, trading profits are not apportionable in any circumstances. Rather, even when the goods are purchased in Hong Kong and sold elsewhere (or purchased elsewhere and sold in Hong Kong), such profits are, according to the Department, ‘either wholly taxable or wholly non-taxable.’ [121] Moreover, the Department's ‘initial presumption’ is that a profit made by buying goods in Hong Kong and selling them elsewhere is derived in its entirety from Hong Kong; [122] and apparently it is only in ‘rare cases' that the Department will accept that this presumption can be rebutted. [123] Again, this analysis seems to be derived from the Dock case, for the Dock case was the source both of the ‘rare case’ doctrine and of the notion that apportionment does not have a ‘wide application.’

*18 But, again, the reasoning in the Dock case is based on Kirk and Hillsdon Watts, and the Hong Kong Inland Revenue Department's current position on the source of trading profits is not readily reconcilable with either Kirk or Hillsdon Watts. In Kirk, the Privy Council held that a profit made by manufacturing goods in New South Wales and selling them in the United *83 Kingdom was derived partly from New South Wales and partly from the United Kingdom; and that apportionment was therefore required. Whether Kirk's case means that a profit made by buying goods in one jurisdiction and selling them in another must be apportioned is debatable. [124] But, if it does not, it seems clear that the rule in Kirk's case is an exception to (and therefore also confirmation of) a more general rule that a profit made on the sale of goods is derived in its entirety from the place where the goods are sold. [125] In Hillsdon Watts, the High Court of Australia held that a profit made by buying goods in New South Wales and selling them elsewhere was derived partly from New South Wales and partly from outside New South Wales, and that apportionment was therefore required.

*18 Moreover, the part of Hillsdon Watts upon which Reece J relied in the Dock case was the passage of Dixon J recited above; [126] and, as authority for the views there expressed, Dixon J cited Murray [127] and Angliss. [128] But the current position of Hong Kong's Inland Revenue Department on the source of trading profits seems irreconcilable with these cases also. In Murray, it was held unanimously (by a court of which Dixon J was a member) that a profit made by buying goods in the United Kingdom and selling them in Western Australia was derived entirely from Western Australia, where the goods were sold. In Angliss, the majority (in a judgment delivered by Dixon J) held that a profit made by buying goods in Australia and selling them in the United Kingdom was derived entirely from the United Kingdom, although it was held also that source-based income tax legislation might implicitly require the apportionment of trading profits in circumstances other than those of the case before the court.

*19 Thus, these four cases (Kirk, Murray, Angliss, and Hillsdon Watts) and many others [129] seem clearly to establish that a profit made by buying goods in one jurisdiction and selling them in another is derived in its entirety from the place where the goods are sold, unless apportionment is required, in which case part (but only part) of the profit is attributable to the place where the goods are purchased. In contrast, the Department's position (that a profit made by buying goods in Hong Kong and selling them elsewhere is entirely derived from Hong Kong, except in rare cases) enjoys very little judicial support. [130]

The scope of the rule in Kirk's case

*19 The rule in Kirk's case can be expressed at various levels of generality. Conceivably, the rule is confined to manufacturers. In other words, it is possible that source-based income tax legislation implicitly requires the apportionment of profits made by manufacturing goods in one jurisdiction and selling them in another, [131] but not of profits made by any other method. It is also possible, however, that the rule should be formulated in broader terms. At its broadest, it is possible to interpret Kirk's case as establishing that source-based income tax legislation implicitly requires [132] apportionment in all cases in which the taxpayer has derived a profit from a ‘series of operations,’ some performed within the taxing jurisdiction and some outside it. In other words, it is possible that Dixon J, in suggesting that there exist categories of profit which are not apportionable, was simply wrong. Perhaps the clearest expression of this interpretation is the following statement from the judgment of Starke J in Dickson v Commissioners of Taxation: [133]

*19 If the income was derived from a series of operations, some of which were performed in New South Wales and some outside that state, then some part of that income must be attributed to sources outside New South Wales, and an apportionment is necessary.

*19 The rule in Kirk's case has been considered in a number of subsequent Privy Council decisions, but these provide little guidance as to the scope of the rule. *85 The only cases (apart from Kirk's case itself) in which the Privy Council has ordered apportionment seem to be International Harvester Co of Canada Ltd v Provincial Tax Commission [134] and Provincial Treasurer of Manitoba v Wm J Wrigley Co Ltd [135] but, as I have indicated, [136] neither of these cases is of much assistance in defining the scope of the rule in Kirk's case.

*20 The possibility of apportionment was also considered, but rejected, by the Privy Council in Commissioner of Taxes v British Australian Wool Realization Association Ltd [137] (the BAWRA case) and in the Hong Kong case Commissioner of Inland Revenue v Hang Seng Bank Ltd. [138] The taxpayer in the BAWRA case was a company established for the purpose of disposing of wool which the Australian and British governments had acquired during the First World War but which had proved to be surplus to their requirements. Some of the wool was transferred to the taxpayer by the Australian government. This wool was sold by the taxpayer, on its own account, outside Australia. The commissioner (applying the rule in Kirk's case) assessed the taxpayer on the basis that 25 per cent of the profit on such sales was sourced in Australia and therefore taxable. The taxpayer also sold on commission wool belonging to the British government. Again, the sales were effected outside Australia. The commissioner (again applying the rule in Kirk's case) assessed the taxpayer on the basis that 40 per cent of the profit on these sales was sourced in Australia and therefore taxable. But the Privy Council held that both categories of profit arose entirely outside Australia, that no tax was payable at all, and that the question of apportionment therefore did not arise. The Privy Council said virtually nothing in the BAWRA case, however, as to when apportionment is required and when it is not.

*20 In the Hang Seng Bank case, the taxpayer made profits by buying and selling certificates of deposit in Singapore and London. The issue of apportionment arose because it was maintained on behalf of the Commissioner that, if the taxpayer's profits were not taxable in full, they were at least taxable in part. [139] Counsel for the Commissioner continued:

*20 The apportionment could be done in three ways: (1) by reference to the management costs attributable to the certificate of deposit transactions incurred in Hong Kong and outside Hong Kong; (2) a subjective evaluation by the apportioning tribunal of the relative importance of what was done inside and outside Hong Kong or (3) an equal division. [140]

*20 *86 The Privy Council rejected this submission and held that the profits in question were not taxable at all. In coming to this conclusion, however, the Judicial Committee observed that s 14 of Hong Kong's Inland Revenue Ordinance does implicitly require the apportionment of profits in some circumstances. [141] In other words, the Privy Council effectively confirmed that the rule in Kirk's case applies in Hong Kong although, curiously, the judgment does not mention Kirk's case, or the International Harvester case, [142] or any of the other cases on apportionment. [143] But, although the Judicial Committee rejected the suggestion that apportionment was required in the Hang Seng Bank case, it did not explain why. [144] Thus, although apportionment was considered by the Privy Council in both the BAWRA case and the Hang Seng Bank case, neither of these cases offers much guidance in principle as to when apportionment is required, or how it is to be calculated. Various other Privy Council decisions [145] in which apportionment was not discussed may also, nonetheless, offer some guidance as to when apportionment is not required.

*21 Although the scope of the rule in Kirk's case is unclear, it is difficult to conceive of any principled basis upon which it could be denied that the rule applies to profits produced by supplying services. In other words, it seems clear, given Kirk's case, that source-based income tax legislation implicitly requires the apportionment of profits made by providing services partly within the taxing jurisdiction and partly outside it. [146] Indeed, the problem with the Dock case was precisely Reece J's failure to deal with this point. Beyond its application to services cases, however, very little is clear as to the scope of the rule in Kirk's case.

*21 In particular, it is unclear whether apportionment is required, in any circumstances, of profits made by selling goods which the taxpayer has purchased, rather than manufactured. This question has been considered by the courts on several occasions, but never definitively answered. But if (as Kirk's case seems clearly to establish) a profit made by manufacturing goods in Hong Kong and selling them elsewhere is in some circumstances taxable only in part *87 in Hong Kong, it would be absurd if a profit made by merely buying goods in Hong Kong and selling them elsewhere were necessarily taxable in full. Therefore, if Kirk's case, properly interpreted, requires apportionment of profits made by manufacturing goods in one jurisdiction and selling them in another, but not of profits made by buying goods in one jurisdiction and selling them in another, the case must also be taken as confirming that a profit made by buying goods in one jurisdiction and selling them in another is derived, in its entirety, from the place where the goods are sold. This interpretation is supported by the Privy Council's decisions in Lovell & Christmas Ltd [147] and in the BAWRA case [148] and by the decision of the High Court of Australia in Murray. [149]

*21 It is also possible, however, that the rule in Kirk's case applies to profits made by buying goods in one jurisdiction and selling them in another. In other words, it is possible that s 14 of Hong Kong's Inland Revenue Ordinance, properly interpreted in accordance with Kirk's case, implicitly requires the apportionment of profits made by buying goods in Hong Kong and selling them elsewhere. This interpretation is most clearly supported by Michell v Federal Commissioner of Taxation, [150] in which the taxpayer bought goods in Australia and sold them elsewhere. The court held that 50:50 apportionment was required. Similarly, in Dalgety & Co Ltd v Commissioner of Taxation [151] the taxpayer, in Western Australia, entered into agreements with a number of Western Australian primary producers to sell their produce on commission in the United Kingdom. It was held that apportionment was required of the profits produced in this way. And the High Court of Australia in Hillsdon Watts [152] ordered apportionment of a profit made by buying and selling goods.

*22 The current position of Hong Kong's Inland Revenue Department (that trading profits are not apportionable in any circumstances) seems to be based on the suggestion made by Dixon J in Hillsdon Watts (and inappropriately adopted by Reece J in the Dock case) that some categories of profit are not apportionable. In other words, the Department's position seems to be, first, that Dixon J's dictum is correct and, second, that the dictum applies to trading profits. It is worth emphasising, however, that Dixon J, although suggesting in Hillsdon Watts that some kinds of profit are not apportionable, did not regard trading profits as one of those kinds. On the contrary, it is clear from his judgment in Angliss [153] that Dixon J regarded trading profits as apportionable in some circumstances.

*22 *88 Alternatively, it may be that the rule in Kirk's case should be defined by reference not to the method by which the taxpayer produced the profit in question, but (as proposed in Murray [154] and Angliss [155]) to added value. That is, apportionment is required if (and only if) the taxpayer has added value both within and without the taxing jurisdiction. And, in such cases, the profit chargeable to tax is to be calculated by reference to the value added within the taxing jurisdiction. In other words, on this analysis, added value determines both whether apportionment is required and how it is to be calculated. [156]

*22 The consequences of this analysis are profound. In Angliss, the taxpayer manufactured goods in Australia and sold them in the United Kingdom. The taxpayer could not have sold the goods in Australia at a profit. On this basis, the majority (in the High Court of Australia) held that none of the profit was derived from Australia, that the whole of the profit was derived from the United Kingdom, and, therefore, that the profit was not taxable at all. In other words, the principle in Kirk's case did not apply and apportionment was not required. If this is correct, Hong Kong manufacturers [157] should escape Hong Kong tax on their exports altogether, if they can establish that no market for their goods exists in Hong Kong. But the analysis in Angliss cuts both ways. If the Hong Kong manufacturer could have sold the goods in Hong Kong and thereby realised a profit equal to the profit in fact made by selling its goods outside Hong Kong, then none of the added value is attributable to the selling of the goods outside Hong Kong. Thus, Dixon J's reasoning in Angliss seems to lead to the conclusion that in such cases apportionment is not required. In other words, if the whole of the profit is attributable to value added in Hong Kong by the manufacturing of the goods, rather than to the effecting of sales outside Hong Kong, then the whole profit is derived from Hong Kong and is therefore taxable in Hong Kong. Finally, it is possible that the firm might have been able to sell the goods in Hong Kong at a profit, but a smaller profit than was in fact realised by selling them outside Hong Kong. In this case, Dixon J's analysis in Angliss requires that the profit be apportioned. To the extent that a profit could have been made by selling the goods in Hong Kong, the actual profit should be regarded as having been derived from Hong Kong. The actual profit is, therefore, taxable to that extent. But to the extent that the actual profit exceeds the profit which could have been made by selling the goods in Hong Kong, it is derived from the place where the goods were sold and, therefore, is not taxable in Hong Kong.

*23 *89 According to Angliss, much the same reasoning applies to trading profits. Thus, if a firm makes a profit by buying goods in Hong Kong and selling them outside Hong Kong, the profit might be derived entirely from the purchase, entirely from the sale, or partly from the purchase and partly from the sale, depending on the circumstances. Consequently, the profit might be taxable in full in Hong Kong, or not taxable at all, or taxable in part. If the firm could not have made any profit at all by selling the goods in Hong Kong, the whole of the profit must be attributed to the place where it sold them. (It was for precisely this reason that the majority held in Angliss that the taxpayer's profit on the sale in the United Kingdom of tallow which it had purchased from other suppliers in Australia was not taxable at all in Australia. That is, the taxpayer in Angliss could not have sold the tallow in Australia at a profit at all.) Conversely, if the firm could have sold the goods in Hong Kong, and thereby realised a profit equal to the profit in fact made by selling the goods elsewhere, then none of the added value is attributable to the selling of the goods outside Hong Kong. Consequently, in this case, the whole of the profit would be attributable to the purchases and would therefore be taxable in Hong Kong. Finally, as in the case of a manufacturer, it is possible that the trader might have been able to sell its goods in Hong Kong at a profit, but a smaller profit than was in fact realised by selling them outside Hong Kong. In this case, again, Dixon J's analysis in Angliss requires that the profit be apportioned.

*23 It is also possible that the rule in Kirk's case, whether applicable to trading profits or not, is subject to various other qualifications. In particular, it seems possible that the rule might be subject to a de minimis exception. Thus, if the part of the profit derived from outside Hong Kong is insubstantial, it may be disregarded, and so the profit is taxable in full. Conversely, if the part of the profit derived from within Hong Kong is insubstantial, then it can be disregarded, and so the profit is not taxable at all. Take, for example, the case of a profit made by manufacturing goods in Hong Kong and selling them outside Hong Kong. The facts of the case might suggest that almost the whole of the profit was derived from the manufacturing of the goods in Hong Kong, and that only a very small part of the profit was attributable to the selling of the goods outside Hong Kong. In such a case, it might be legitimate to disregard the fact that a small part of the profit was derived from outside Hong Kong. If so, the profit would be taxable in full. Conversely, if a firm manufactures goods outside Hong Kong and sells them in Hong Kong, the facts of the case might suggest that virtually the whole of the profit thereby produced is sourced outside Hong Kong. If so, the correct conclusion may be that the profit is not taxable in Hong Kong at all. It must be acknowledged, however, that although it would seem *90 reasonable to confine the rule in Kirk to cases which are not de minimis, the idea seems not to have been raised by, or before, the courts. [158]

*24 At one point, the Australian taxing authorities seem to have drawn a distinction between two different ways in which an Australian exporter (whether a manufacturer or a trader) might operate its business. If the firm exported its goods first, and then sold them, the authorities accepted (on the basis of Kirk's case) that part of the profit was derived from outside Australia. But if the firm entered into a contract of sale first, and then shipped the goods, the authorities maintained that the whole profit was derived from Australia. But this distinction seems not to have been based on any legal authority and subsequently to have been abandoned by the authorities. [159]

*24 In Kirk's case, and in most of the other cases in which it was held that apportionment was required, [160] the taxpayer had a permanent establishment in both of the jurisdictions concerned. Lest it be suggested, on this basis, that Hong Kong's Inland Revenue Ordinance requires apportionment only where the taxpayer has a permanent establishment outside Hong Kong, it may be worth explaining why this seems to be wrong. The reason is that one of the few aspects of the source principle which seem to have been established beyond doubt is that it is possible for a firm to carry on business in Hong Kong, and nowhere else, and yet to derive profit from outside Hong Kong. [161] The proposition that apportionment is required only if the taxpayer has a permanent establishment outside Hong Kong seems impossible to reconcile with this proposition, for it would be absurd for the law to be that a profit can be entirely derived from outside Hong Kong even if the taxpayer has no permanent establishment outside Hong Kong, but that a profit can be partly derived from outside Hong Kong only if the taxpayer has a permanent establishment outside Hong Kong. That this is so is confirmed by a number of cases in which the taxpayer had no offshore permanent establishment and yet it was held that apportionment was required. [162] On the other hand, if the rule in Kirk's case is subject to a de minimis exception, the existence of a permanent establishment *91 outside Hong Kong might assist the taxpayer in demonstrating that the part of its profit derived from outside Hong Kong is not de minimis.

*24 Whether apportionment might, depending on the circumstances, be required of other forms of profits, such as interest, royalties, dividends, insurance premiums, and sums received for the use of movable property, is unclear. The Australian courts seem consistently to have held that profits of these kinds are either taxable in full or not at all. [163] But, even if it is assumed that these decisions are correct, it does not follow that such profits are never apportionable, in any circumstances. On the contrary, there seems every reason to regard the rule in Kirk's case as applicable to profits of these kinds in some circumstances. The issues are too complex to address comprehensively here, but take, for example, a profit made by hiring out movable property, such as machinery. Depending on the circumstances, such a profit can have its source, it seems, in the place where the machinery is used by the hirer. [164] Therefore, if the hirer uses the machinery partly in Hong Kong and partly outside Hong Kong, apportionment is required.

Conclusion

*25 In 1900, in Kirk's case, the Privy Council established the basic rule that source-based income tax legislation requires the apportionment, in some circumstances at least, of profits derived partly from within the taxing jurisdiction and partly outside it. As a Privy Council decision rendered before 1 July 1997, Kirk's case may still be of binding authority in Hong Kong. Presumably the Court of Final Appeal will regard itself as competent to depart from Privy Council decisions but will take this course only where there exist compelling reasons for doing so. But, although Kirk's case establishes that apportionment is required in some circumstances, it gives little guidance as to what those circumstances are, and even less as to how, in circumstances in which apportionment is required, it is to be calculated. The Privy Council also discussed apportionment in several other cases [165] but none of them contributes much to the resolution of the questions left unanswered in Kirk.

*25 *92 There are also, of course, the Australian cases. [166] These add up to a very substantial body of jurisprudence, created by some very strong courts. But the Australian cases, although obviously relevant to the interpretation of the rule in Kirk's case (and also, therefore, to the interpretation of s 14 of Hong Kong's Inland Revenue Ordinance), nonetheless failed to resolve the basic uncertainties as to the scope of the rule. [167] Also, of course, the decisions of the Australian courts (unlike those of the Privy Council) are not binding on the courts of Hong Kong.

*25 Thus it can be concluded only that the scope of Hong Kong profits tax remains uncertain. It is clear that s 14 of the Inland Revenue Ordinance requires the apportionment of profits in some circumstances; and it seems clear also that most of what Reece J said about apportionment in the Dock case was at best misleading, if not wrong; but fundamental uncertainties persist both as to when apportionment is required and as to how, in circumstances in which it is required, it is to be calculated. [168] Since these questions are of substantial practical importance, it seems likely that Hong Kong's courts will sooner or later be called upon to answer them, and it is to be hoped that, when so called upon, they will address the issues squarely, and that they will not perpetuate the plainly flawed reasoning in the Dock case.

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1. . (1960) 1 HKTC 85;[1960] HKLR 166.

2. . The first reported Hong Kong case on source was Commissioner of Inland Revenue v Karsten Larssen & Co (HK) Ltd (1951) 1 HKTC 11.Curiously, the Karsten Larssen case seems not to have been cited in the Dock case, for the Full Court was plainly unaware of it: (1960) 1 HKTC 85, 99.

3. . See eg Commissioner of Inland Revenue v HK-TVB International Ltd [1992] 2 AC 397 (PC);Commissioner of Inland Revenue v International Wood Products Ltd (1971) 1 HKTC 551;Sinolink Overseas Ltd v Commissioner of Inland Revenue (1985) 2 HKTC 127;Bank of India v Commissioner of Inland Revenue (1988) 2 HKTC 503.

4. . See eg Peter Willoughby and Andrew Halkyard, Encyclopaedia of Hong Kong Taxation (Hong Kong: Butterworths, loose-leaf), paras 5896-6885.

5. . See eg Jefferson VanderWolk, The Source of Income: Tax Law and Practice in Hong Kong (Hong Kong: Longman, 1994), p 35, where Reece J's judgment in the Dock case is described as 'admirable in its completeness and its circumspection,'although, at p 36,'perhaps' wrong.

6. . See note 10 below.

7. . [1900] AC 588.

8. . The Inland Revenue Ordinance does not provide for an income tax as such, but for separate taxes on rents, income from employment, and business profits. Whilst this distinction is fundamentally important, I have occasionally referred to the ordinance as establishing a system of income tax because there seems to be no convenient alternative.

9. . The Privy Council has held that there is little if any difference between the terms 'arising in' and 'derived from' as appearing in s 14 of the Inland Revenue Ordinance (Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306)and they are treated as synonymous in this article.

10. . Except for, now, the Court of Final Appeal. See notes 68 and 165 below and the accompanying text.

11. . This headnote is recited verbatim in the text corresponding to note 25 below.

12. . (1960) 1 HKTC 85, 117.

13. . Strictly speaking, the Privy Council does not deliver 'judgments' but renders 'advice'; but since the Privy Council itself applies the term 'judgment' to its decisions, I have followed the same practice.

14. . [1991] 1 AC 306.

15. . Commissioner of Inland Revenue, Departmental Interpretation and Practice Notes No 21 (Revised 1998): Locality of Profits (March 1998), para 22.

16. . Whether it might be desirable, as a matter of policy, for Hong Kong firms to be taxed on their total profits is, of course, debatable. But that is not the point, for my concern here is merely with the law as it stands. As Lord Davey said in Kirk'scase, 'At first sight it seems startling that the ultimate result in the form of profit of a business carried on in [New South Wales] is not to some extent taxable income there, but if it cannot be brought within the language of the Act that must of course be the result': [1900] AC 588, 592.

17. . (1936-7) 57 CLR 36.

18. . [1900] AC 588.

19. . In fact, some of the ore was processed in South Australia also, but the Privy Council ignored this 'for the purpose of simplicity': [1900] AC 588, 593.This seems sound for if, as the Privy Council held, apportionment is required where goods are processed in one jurisdiction and sold in another, apportionment must also a fortiori be required where goods are processed in two jurisdictions and sold in a third.

20. . The word 'effect' is very commonly used in cases on source in connection with purchases, sales, and contracts of all kinds. See, for example, the text accompanying note 44 below and Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306.There has been some debate about what the word means in this context, but the better view is that to 'effect' a contract means to enter into it, and that is what I mean by it in this article. Similarly, when I refer to the place where goods are sold, I mean the place where the contract of sale is entered into. Both usages are, however, subject to two qualifications. First, a firm which has negotiated and arranged a contract within the taxing jurisdiction cannot escape tax merely by executing it somewhere else: Tariff Reinsurances Ltd v Commissioner of Taxes (Victoria) (1938) 59 CLR 194, 208,per Rich J, Firestone Tyre and Rubber Co Ltd v Lewellin [1957] 1 WLR 464.Second, given that source 'is always in the last analysis a question of fact'(Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306, 322)and that it is 'impossible to lay down precise rules of law by which the answer to that question is to be determined'(ibid), it would be wrong to exclude performance as a priori irrelevant to determining the source of a profit. Note also that in many of the cases (eg International Harvester Co of Canada Ltd v Provincial Tax Commission [1949] AC 36) in which the profit in question was made by selling goods, the goods were situated in the place where the contracts of sale were entered into. But see note 159 below and the accompanying text.

21. . [1900] AC 588, 591.

22. . (1897) 18 NSWLR 378.

23. . Commissioners of Taxation v Broken Hill Proprietary Co (1898) 19 NSWLR 294.

24. . Confirmation that this interpretation of Commissioners of Taxation v Kirkis correct (and that the interpretation apparently favoured by Reece J in the Dock case is wrong) can be found in a number of cases including International Harvester Co of Canada Ltd v Provincial Tax Commission [1949] AC 36 (PC), Provincial Treasurer of Manitoba v Wm Wrigley Jr Co Ltd [1950] AC 1 (PC), Commissioners of Taxation v Meeks (1915) 19 CLR 568,581-3,Commissioner of Taxes v The Kauri Timber Co Ltd (1904) 24 NZLR 18, 32-3,Commissioner of Taxation of Western Australia v D & W Murray Ltd (1929) 42 CLR 332,Federal Commissioner of Taxation v W Angliss & Co Pty Ltd (1927) 46 CLR 417,Mount Morgan Gold Mining Co Ltd v Commissioner of Taxation (Queensland) (1922-3) 33 CLR 76,Dickson v Commissioner of Taxation (New South Wales) (1925) 36 CLR 489,and Commissioner of Taxation (New South Wales) v Hillsdon Watts Ltd (1936-7) 57 CLR 36.Note also that the Privy Council in Kirk'scase seems to have assumed that a profit made by buying (rather than manufacturing) goods and selling them is derived entirely from the place where the goods are sold. See also Lovell & Christmas Ltd v Commissioner of Taxes [1908] AC 46 (PC)and Commissioner of Taxes v British Australian Wool Realization Association Ltd [1931] AC 224 (PC).

25. . [1900] AC 588.

26. . (1960) 1 HKTC 85, 117.

27. . In Reece J's defence, it must be acknowledged that he seems not to be the only judge to have misinterpreted Kirk'scase. See Commissioners of Taxation (New South Wales) v Meeks (1915) 19 CLR 568, 580-3,where Isaacs J observed: ‘Kirk'scase does not decide so much as was assumed [ie that the whole profit was taxable], probably from the way in which the headnote is worded.’

28. . The question was phrased in the singular because BHP's appeal and its subsidiary's appeal were separate, although heard together.

29. . (1897) 18 NSWLR 378.

30. . Commissioners of Taxation v Broken Hill Pty Co (1898) 19 NSWLR 294, 297.

31. . [1900] AC 588, 594.

32. . See Commissioner of Taxes v Kauri Timber Ltd (1904) 24 NZLR 18, 32-3for the observations of Edwards, Williams, Denniston, and Cooper JJ on this aspect of Kirk'scase.

33. . Another factor contributing to Reece J's misreading of Kirkmay have been that the Privy Council awarded costs to the Commissioners. Given that the Judicial Committee in effect upheld in part the taxpayers' successful appeals against the original assessments (by holding that their profits were taxable only in part, not entirely), this award calls for an explanation, but the judgment (as reported) contains none.

34. . The conspicuous exception was Britain itself, which had always, for as long as it had had a system of income tax, attempted to tax residents on their offshore incomes. Britain favoured source-based income tax systems in its colonies ostensibly on the basis that they were in the colonies' own interest (Report of the Inter-Departmental Committee on Income Tax in the Colonies Not Possessing Responsible Government, Cmd 1788), but it would be naïve not to note that Britain itself was presumably a substantial beneficiary of this policy.

35. . Singapore, Malaysia, and South Africa also still maintain source-based systems of income tax.

36. . The cases include Commissioner of Taxes for New Zealand v Eastern Extension Australasia and China Telegraph Co Ltd [1906] AC 526 (PC), Lovell & Christmas Ltd v Commissioner of Taxes [1908] AC 46 (PC), Nathan v Federal Commissioner of Taxation (1918) 25 CLR 183,Public Officer of the Studebaker Corporation of Australia Ltd v Commissioner of Taxation for New South Wales (1921) 29 CLR 225,Sixsmith v Commissioner of Taxation (1928) 28 NSWLR 456,Commissioner of Income Tax v Remington Typewriter Co (Bombay) Ltd (1930) LR 58 IA 42 (PC),Re Port Said Salt Association (1932) ILR Calcutta Series 1226, Commissioner of Taxes v Union Trustee Co of Australia Ltd [1931] AC 258 (PC), Premier Automatic Ticket Issuers Ltd v Federal Commissioner of Taxation (1933) 50 CLR 268,Commissioner of Taxation (New South Wales) v Premier Automatic Ticket Issuers Ltd (1933) 50 CLR 304,Tariff Reinsurances Ltd v Commissioner of Taxes (Victoria) (1938) 59 CLR 194,Commissioner of Income Tax, Bombay Presidency and Aden v Chunilal B Mehta (1938) LR 65 IA 332 (PC),Liquidator, Rhodesia Metals Ltd v Commissioner of Taxes [1940] AC 774 (PC), Firestone Tire & Rubber Co of Canada Ltd v Commissioner of Income Tax [1942] 4 DLR 433,Federal Commissioner of Taxation v United Aircraft Corporation (1943) 68 CLR 525,Commissioner of Inland Revenue v N V Philips' Gloeilampenfabrieken [1955] NZLR 867, Commissioner of Taxes v British United Shoe Machinery (SA) (Pty) Ltd (1964) 26 SATC 163, and Transvaal Associated Hide and Skin Merchants v Collector of Income Tax, Botswana (1967) 29 SATC 97. For reviews of the Hong Kong cases on source, see Willoughby and Halkyard (note 4 above), paras 5896-6885 and VanderWolk (note 5 above).

37. . The cases include Commissioner of Taxes v Kauri Timber Co Ltd (1904) 24 NZLR 18,Commissioners of Taxation v Meeks (1915) 19 CLR 568,Dalgety & Co Ltd v Commissioner of Taxation (1919) 21 WALR 21,Commissioner of Taxation of Western Australia v D & W Murray Ltd (1929) 42 CLR 332,Federal Commissioner of Taxation v W Angliss & Co Pty Ltd (1931) 46 CLR 417,Mount Morgan Gold Mining Co Ltd v Commissioner of Taxation (Queensland) (1922-3) 33 CLR 76,Dickson v Commissioner of Taxation (New South Wales) (1925) 36 CLR 489,Federal Commissioner of Taxation v Lewis Berger & Sons (Australia) Ltd (1927) 39 CLR 468,Michell v Federal Commissioner of Taxation (1927) 46 CLR 413,Commissioner of Taxes v British Australian Wool Realization Association Ltd [1931] AC 224 (PC), Re A Taxpayer (1933) 28 TasLR 58,Commissioner of Taxation v Cam & Sons Ltd (1936) 36 NSWLR 544,Commissioner of Taxation (New South Wales) v Hillsdon Watts Ltd (1936-7) 57 CLR 36,Re Income Tax Act, 1932, & Proctor & Gamble Co [1938] 2 DLR

597, International Harvester Co of Canada Ltd v Provincial Tax Commission [1949] AC 36 (PC), and Provincial Treasurer of Manitoba v Wm Wrigley Jr Co Ltd [1950] AC 1 (PC).

38.
. But it would be remiss not to mention (1) that the number of Australian (and New Zealand, Canadian, Indian, and African) cases on source and apportionment is substantial (see notes 39 and 40 above); (2) that they include a number of Privy Council decisions; and (3) that these cases have received considerable lip-service but have been otherwise largely ignored in Hong Kong. Some of the Australian, New Zealand, and Canadian cases are reviewed in Michael Littlewood, 'The Geographical Scope of Hong Kong Profits Tax: Manufacturers, Traders, and Apportionment,'Tax Notes International, 10 November 1997, p 1549. See also VanderWolk (note 5 above) and Willoughby and Halkyard (note 4 above), paras 5896-6885.

39.
. In addition to the cases mentioned in the text, the Privy Council decisions on the source principle include Commissioner of Taxes for New Zealand v Eastern Extension Australasia and China Telegraph Co Ltd [1906] AC 526, Commissioner of Income Tax v Remington Typewriter Co (Bombay) Ltd (1930) LR 58 IA 42,Commissioner of Taxes v British Australian Wool Realization Association Ltd [1931] AC 224, Commissioner of Taxes v Union Trustee Co of Australia Ltd [1931] AC 258, Commissioner of Income Tax, Bombay Presidency and Aden v Chunilal B Mehta (1938) LR 65 IA 332,Liquidator Rhodesia Metals Ltd v Commissioner of Taxes [1940] AC 774. There have also, since the Dock case, been three Hong Kong appeals to the Privy Council on the source principle: Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306, Commissioner of Inland Revenue v HK-TVB International Ltd [1992] 2 AC 397,and Commissioner of Inland Revenue v Orion Caribbean Ltd [1997] STC 923. For an analysis of Commissioner of Inland Revenue v Orion Caribbean Ltd,see Michael Littlewood, 'The Orion CaribbeanCase and the Source of Interest'(1999) Asia Pacific Law Review (forthcoming).

40.
. [1908] AC 46.

41.
. [1949] AC 36.

42.
. [1950] AC 1.

43.
. [1908] AC 46. It is worth noting that the wording of the legislation under consideration in Lovell & Christmaswas, insofar as is relevant, virtually identical to the wording of Hong Kong's s 14.

44.
. [1908] AC 46, 52-3.

45.
. [1949] AC 36.

46.
. [1950] AC 1.

47.
. In addition to the cases mentioned in the text, the decisions of the High Court of Australia on source include Commissioners of Taxation v Meeks (1915) 19 CLR 568,Federal Commissioner of Taxation v Lewis Berger & Sons (Australia) Ltd (1927) 39 CLR 468,Michell v Federal Commissioner of Taxation (1927) 46 CLR 413,Nathan v Federal Commissioner of Taxation (1918) 25 CLR 183,Public Officer of the Studebaker Corporation of Australia Ltd v Commissioner of Taxation for New South Wales (1921) 29 CLR 225,Premier Automatic Ticket Issuers Ltd v Federal Commissioner of Taxation (1933) 50 CLR 268,Commissioner of Taxation (New South Wales) v Premier Automatic Ticket Issuers Ltd (1933) 50 CLR 304,Tariff Reinsurances Ltd v Commissioner of Taxes (Victoria) (1938) 59 CLR 194,and Federal Commissioner of Taxation v United Aircraft Corporation (1943) 68 CLR 525.

48.
. (1922-3) 33 CLR 76.

49.
. (1925) 36 CLR 489.

50.
. (1929) 42 CLR 332.

51.
. [1908] AC 46.

52.
. (1929) 42 CLR 332, 346.

53.
. (1927) 46 CLR 417.

54.
. Such as Commissioners of Taxation v Kirk [1900] AC 588, Mount Morgan Gold Mining Co Ltd v Commissioner of Taxation (Queensland) (1922-3) 33 CLR 76,Dickson v Commissioner of Taxation (New South Wales) (1925) 36 CLR 489,Commissioner of Taxes v Kauri Timber Co Ltd (1904) 24 NZLR 18,Federal Commissioner of Taxation v Lewis Berger & Sons (Australia) Ltd (1927) 39 CLR 468,and Michell v Federal Commissioner of Taxation (1927) 46 CLR 413.See also International Harvester Co of Canada Ltd v Provincial Tax Commission [1949] AC 36 (PC)and Provincial Treasurer of Manitoba v Wm Wrigley Jr Co Ltd [1950] AC 1 (PC).

55.
. (1931) 46 CLR 417, 434.

56.

. Ibid, p 435.

57. . Ibid, p 434.

58. . (1936-7) 57 CLR 36.

59. . The point of Kirk'scase, and of the other cases discussed in this article in which Kirk'scase was followed, was that apportionment was not expressly but implicitly required.

60. . Section 28(1) was worded as follows: ‘Whenever - (a) by reason of the manufacture, extraction from the earth, winning, production or purchase of any goods, substance, product, or commodity in the State [of New South Wales]; or (b) by reason of successive steps of extraction, winning, production, or manufacture in and outside the State; or (c) by reason of the making of contracts in the State and their performance outside the State or vice versa; or (d) for any other like reason, the source of any income is not exclusively in the State, that income shall be apportioned between its source in the State and its source outside the State in such manner as shall be determined by the commissioner’. (1936-7) 57 CLR 36, 45-6.

61. . See note 37 above.

62. . (1936-7) 57 CLR 36, 43.

63. . Ibid, pp 51-2.

64. . (1960) 1 HKTC 85.

65. . The Paracel Islands are situated in the South China Sea, a considerable distance from Hong Kong. Although their ownership is disputed, they are clearly not part of Hong Kong.

66. . The Board of Review held that the profit was derived from outside Hong Kong and therefore was not taxable at all; Gregg J in the Supreme Court held the profit was taxable in full. The case stated by the Board, the judgment of Gregg J in the Supreme Court, and the judgments of Reece, Blair-Kerr, and Macfee JJ in the Full Court are all reported together at (1960) 1 HKTC 85.

67. . (1960) 1 HKTC 85, 114.

68. . It seems that, prior at least to the handover in 1997, Privy Council decisions from other jurisdictions were no less binding than Privy Council decisions from Hong Kong. See Fatuma Binti Mohamed Bin Salim Bakhshuwen v Mohamed Bin Salim Bakhshuwen [1952] AC 1, Mayer v Coe [1968] 2 NSWLR 747,Tsui Kwok-leung v AG [1990] 1 HKLR 704,and Peter Wesley Smith, The Sources of Hong Kong Law (Hong Kong: Hong Kong University Press, 1994), pp 181-201.

69. . It might be suggested that Kirk'scase does not apply in Hong Kong because the wording of the New South Wales statute was not identical to Hong Kong's Inland Revenue Ordinance, but this point seems misconceived, for a variety of courts (including the Privy Council) have held, following Kirk'scase, that a variety of differently-worded source-based income tax statutes implicitly require the apportionment of profits derived partly from within the taxing jurisdiction and partly outside it. See, in particular, International Harvester Co of Canada Ltd v Provincial Tax Commission [1949] AC 36 (PC)and Provincial Treasurer of Manitoba v Wm Wrigley Jr Co Ltd [1950] AC 1 (PC). In Commissioner of Taxation v D & W Murray Ltd (1929) 42 CLR 332, 349,the High Court of Australia (Knox CJ, Rich and Dixon JJ) made the point as follows: ‘But refined distinctions ought not to be drawn between the forms of expression used in legislation dealing with this subject and directed to discriminate between extra-territorial and intra-territorial profits or income. Moreover, these authorities proceed upon a principle and not upon the particular meaning of words or expressions. Their application to enactments in pari materia is fully authorized by the Privy Council in Lovell & Christmas Ltd v Commissioner of Taxes [1908] AC 46.’See Littlewood, ‘The Geographical Scope’ (note 38 above), pp 1558-60.

70. . Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306, 323.

71. . Commissioner of Inland Revenue (note 15 above), paras 20(e) and 21.

72. . It is thus a curious irony that, according to the currently prevailing interpretation of s 14, the Dock case seems to have been wrongly decided, and yet that very interpretation is substantially based on the Dock case.

73. . (1936) 36 NSWLR 544.See also Diamond v Commissioner of Taxes (Queensland) (1941) 6 ATD 111,Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd [1946] SAR 1, 8-9, and Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306, 323.

74. . See note 156 below and the accompanying text.

75.

. Even Dixon J in Commissioner of Taxation (New South Wales) v Hillsdon Watts Ltd (1936-7) 57 CLR 36 (see text at note 78 below)can hardly have meant that apportionment is required only in circumstances where the precise calculation is so manifest as to be beyond dispute, given that this clearly was not the case in Kirk.

76.
. Commissioners of Taxation v Kirk [1900] AC 588, International Harvester Co of Canada Ltd v Provincial Tax Commission [1949] AC 36, and Provincial Treasurer of Manitoba v Wm Wrigley Jr Co Ltd [1950] AC 1.

77.
. Although Reece J's reasoning in the Dock case seems plainly deficient, it does not necessarily follow that his conclusion is wrong. In other words, it might be possible to salvage the decision on other grounds than those offered by Reece J. In particular, it seems plausible to suggest that the rule in Kirk'scase is subject to a de minimis exception. This possibility is examined below at note 158 and the accompanying text.

78.
. (1936-7) 57 CLR 36, 51-2,quoted by Reece J in the Dock case at (1960) 1 HKTC 85, 115-16. Reece J also incorporated in his judgment the three paragraphs preceding the one I have recited here, but I have omitted these, as nothing seems to depend on them. Reece J omitted the references to Murrayand Anglisswith which the crucial paragraph concludes but I have restored them for two reasons. First, both cases are important, although commonly ignored in Hong Kong. Second, Reece J might not have misinterpreted Kirk'scase at all, had he paid greater heed to Murrayand Angliss.

79.
. See notes 131-64 below and the accompanying text.

80.
. Although it seems to have been clearly established that cases on source generally cannot be distinguished on the basis of differences in the wording which the legislature has used to distinguish between domestic and offshore profits (see note 69 above), the Hillsdon Wattscase is exceptional, in that the statute there in issue expressly provided for apportionment.

81.
. But compare Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306.

82.
. [1949] AC 36.

83.
. [1950] AC 1.

84.
. See notes 163-4 below and the accompanying text.

85.
. (1960) 1 HKTC 85, 116.

86.
. Ibid, p 117.

87.
. It seems to be generally assumed in Hong Kong that Dixon J was correct but, given the lack of authority on the point, this merely indicates how influential the defectively reasoned Dock case has been. See notes 131-64 below and the accompanying text. See also Hang Seng Bank Ltd [1991] 1 AC 306, 321.

88.
. Kirk [1900] AC 588, International Harvester Co [1949] AC 36, and Wrigley [1950] AC 1.

89.
. See note 37 above.

90.
. See Commissioner of Taxation v Cam & Sons Ltd (1936) 36 NSWLR 544.

91.
. See note 78 above and the accompanying text.

92.
. (1960) 1 HKTC 85, 113.

93.
. See notes 25-7 above and the accompanying text.

94.
. (1897) 18 NSWLR 378.

95.
. [1900] AC 588, 593,quoted by Reece J at (1960) 1 HKTC 85, 117. Reece J described the Privy Council's ‘observations' in Kirkas ‘most helpful.' Actually, of course, Kirk'scase was binding on Reece J (unless he thought it distinguishable, but he did not suggest that this was the case).

96.
. This phrase seems to be derived from the dictum of Starke J in Dickson v Commissioners of Taxation (1925) 36 CLR 489, 511:see note 133 below.

97. . See text accompanying note 95 above.

98. . (1936-7) 57 CLR 36, 43-4,quoted by Reece J at (1960) 1 HKTC 85, 117.

99. . (1960) 1 HKTC 85, 115.

100. . Unless, perhaps, the rule in Kirk'scase is subject to a de minimis exception (see note 158 below and the accompanying text) or some other qualification; but Reece J did not suggest that this was so.

101. . For a telling example, see Bank of India v Commissioner of Inland Revenue (1988) 2 HKTC 503,where Nazareth J referred to Dixon J's obiter dictum as 'the Dixon principle' and devoted a substantial part of his judgment to the analysis of it.

102. . Liquidator, Rhodesia Metals Ltd v Commissioner of Taxes [1940] AC 774 (PC), Commissioner of Income Tax, Bombay Presidency and Aden v Chunilal B Mehta (1938) LR 65 IA 332 (PC),Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306 (PC).

103. . Commissioner of Inland Revenue (note 15 above), para 5(f).

104. . [1992] 2 AC 397, 409-10.

105. . Ibid.

106. . Hong Kong's tax system has been formally reviewed three times, in 1954, 1968, and 1976, by committees commonly referred to as the First, Second, and Third Inland Revenue Ordinance Review Committees. It seems clear from the reports of all three committees that the Inland Revenue Department routinely accepted that the profits of firms with places of business in Hong Kong and nowhere else can be derived from outside Hong Kong and therefore outside the charge to tax: Report of the Inland Revenue Ordinance Committee (Hong Kong: Government Printer, 1954), paras 10, 21-2, Hong Kong Hansard, 17 August 1955, 236, Report of the Inland Revenue Ordinance Review Committee Part II (Hong Kong: Government Printer, 1968), paras 74-102, 61-264, Report of the Third Inland Revenue Ordinance Review Committee, 13 December 1976, ch 6. In particular, that a profit made by buying goods in Hong Kong and selling them elsewhere was derived from outside Hong Kong seems to have been regarded as axiomatic. See Andrew Halkyard, 'The Privy Council's Hong Kong Tax Legacy'[1998] BTR 32, 47.

107. . Such as that adopted by the taxpayer in Commissioner of Inland Revenue v Magna Industrial Co Ltd [1997] HKRC 90-082.

108. . Quite apart from the merits of the Department's position, the word 'permissible' in this context is misleading. See note 132 below.

109. . Commissioner of Inland Revenue (note 15 above), para 22.

110. . See Sinolink Overseas Ltd v Commissioner of Inland Revenue (1985) 2 HKTC 127, 130-1.

111. . See notes 131-64 below and the accompanying text.

112. . Except in the case of Hong Kong firms participating in manufacturing operations in the Chinese mainland. See Commissioner of Inland Revenue(note 15 above), paras 13-19.

113. . Ibid,para 13.

114. . Ibid,para 18.

115. . [1900] AC 588.

116. . [1949] AC 36.

117. . [1950] AC 1.

118. . See notes 47-63 above and the accompanying text.

119. . See notes 36-62 above and the accompanying text.

120. . Until at least 1971, the Department seems to have accepted that a profit made by manufacturing goods in Hong Kong and selling them outside Hong Kong was partly derived from outside Hong Kong and, therefore, taxable only in part: see Michael Littlewood, 'The Taxation of Manufacturing Profits: A Re-interpretation'(1997) 27 HKLJ 313.Presumably, its revised position is at least partly attributable to the Dock case. But the Department's previous position seems preferable to its current position, for the simple reason that it is consistent with the cases (see notes 36-7 above), whereas its current position is not.

121. . Commissioner of Inland Revenue (note 15 above), para 11.

122. . Ibid,para 8(c).

123. . Ibid,para 5(f).

124. . See notes 131-64 below and the accompanying text.

125. . Lovell & Christmas Ltd v Commissioner of Taxes [1908] AC 46 (PC), Commissioner of Taxes v British Australian Wool Realization Association Ltd [1931] AC 224 (PC).

126. . See text at note 78 above.

127. . (1929) 42 CLR 332.

128. . (1931) 46 CLR 417.

129. . See in particular Lovell & Christmas Ltd v Commissioner of Taxes [1908] AC 46, Michell v Federal Commissioner of Taxation (1927) 46 CLR 413,and Dalgety & Co Ltd v Commissioner of Taxation (1919) 21 WALR 21and the cases listed in notes 36 and 37 above. The cases on the apportionment of manufacturing profits seem generally to assume that a profit made by buying goods in one jurisdiction and selling them in another has its source entirely in the latter.

130. . The Department's position finds some support in the reasoning (although not the result) in Commissioner of Inland Revenue v Magna Industrial Co Ltd [1997] HKRC 90-082, but the court there discussed neither the possibility of apportionment nor the line of contrary authority beginning with the Privy Council's decisions in Kirk'scase and Lovell & Christmas Ltd [1908] AC 46and ending with Hillsdon Watts Ltd (1936-7) 57 CLR 36.It appears that, until the mid-1980s, the Department accepted that a profit made by buying and selling goods is derived entirely from the place where the goods are sold and, therefore, that a profit made by buying goods in Hong Kong and selling them outside Hong Kong was not taxable in Hong Kong at all: see Halkyard (note 106 above), p 47. In other words, the Department seems to have revised its position on trading profits in much the same way as it revised its position on manufacturing profits (see note 120). Again, the Department's previous position is supported by the cases (Lovell & Christmas Ltd [1908] AC 46, D & W Murray Ltd (1927) 42 CLR 332,W Angliss & Co Pty Ltd (1931) 46 CLR 417),whereas its current position is not. Again, however, it seems likely that the deficiencies in the Department's current position on trading profits are at least partly attributable to Reece J's flawed reasoning in the Dock case.

131. . A fortiori, even in its narrowest form, the rule in Kirk'scase must apply where a firm manufactures goods partly in one jurisdiction and partly in another, irrespective of where the goods are sold. For examples, see Michell v Federal Commissioner of Taxation (1927) 46 CLR 413,Commissioner of Taxes v Kauri Timber Co Ltd (1904) 24 NZLR 18,and the obiter dicta of Lord Bridge in Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306, 323.But this analysis does not necessarily legitimise the Inland Revenue Department's current practices in respect of Hong Kong firms participating in manufacturing operations in the Chinese mainland, except, perhaps, in cases in which some part of the actual manufacturing takes place in Hong Kong.

132. . In Hong Kong, the issue has sometimes been discussed in terms of whether the Inland Revenue Ordinance 'permits' apportionment. For a notable example, see Commissioner of Inland Revenue(note 15 above), para 22, which is quoted above at note 109. But 'permit' is an unfortunate choice of word, because it might be taken to imply that apportionment is somehow discretionary, and this is obviously not so.

133. . (1925) 36 CLR 489, 511.See also text at note 62 above.

134. . [1949] AC 36.

135. . [1950] AC 1.

136. . See notes 45-6 and the accompanying text.

137. . [1931] AC 224.

138. . [1991] 1 AC 306.

139. . Ibid, pp 311 and 321.

140. . Ibid, p 311.

141. . Ibid, p 323.

142. . [1949] AC 36.

143. . See note 37 above.

144. . Their Lordships observed that they were 'at a loss to discover a rational basis'upon which apportionment could be calculated, but they also observed that 'The Court of Appeal's escape from these difficulties, by seeking "a dominant factor or factors which would put the profits on one side of the line or the other,"seems to their Lordships to introduce an unacceptably imprecise and elusive test ...': [1991] 1 AC 306, 321.How the problem is to be resolved seems thus to remain uncertain. The three methods of calculation suggested by counsel for the commissioner are all supported by authority, however. See Michael Littlewood, 'Hong Kong Profits Tax and the Calculation of Apportionment'(1999) Journal of Chinese and Comparative Law (forthcoming). The Hang Seng Bankcase notwithstanding, the Department of Inland Revenue interprets ss 14 and 15(1)(i) as implicitly requiring 50:50 apportionment of financial institutions' profits in some circumstances: Commissioner of Inland Revenue (note 15 above), paras 27 and 28.

145. . See note 39 above.

146. . See notes 68-100 above and the accompanying text.

147. . [1908] AC 46. See notes 40-4 above and the accompanying text.

148. . [1931] AC 224. See notes 137-8 above and the accompanying text.

149. . (1929) 42 CLR 332.See notes 50-2 above and the accompanying text.

150. . (1927) 46 CLR 413.

151. . (1919) 21 WALR 21.

152. . (1936-7) 57 CLR 36.See notes 58-62 above and the accompanying text.

153. . (1931) 46 CLR 417.

154. . (1929) 42 CLR 332.

155. . (1931) 46 CLR 417.

156. . But, given that the Anglisscase is not binding in Hong Kong but merely persuasive, note the strong dissenting judgments of Starke and Evatt JJ, according to whose analysis apportionment seems to be required in all cases in which a profit is produced by operations performed partly within the taxing jurisdiction and partly outside it, irrespective of where value is added.

157. . And, a fortiori, Hong Kong firms involved in manufacturing in the Chinese mainland.

158. . Except that Federal Commissioner of Taxation v Lewis Berger & Sons (Australia) Ltd (1927) 39 CLR 468,Michell v Federal Commissioner of Taxation (1927) 46 CLR 413,and Re a Taxpayer (1933) 28 Tas LR 58suggest that apportionment should be based on the robust application of round figures, rather than on the mathematical product of any predetermined formula. See also Commissioner of Taxes (SR) v Shein (1958) 3 SATC 12. A de minimis exception to the rule in Kirk'scase could also salvage the result in the Dock case. But compare Hillsdon Watts Ltd (1936-7) 57 CLR 36, 54-5,where the observations of Evatt J seem to exclude the possibility of a de minimis exception.

159. . See Norman Bede Rydge, Federal Income Tax Law (Sydney: Butterworth & Co, 1921), pp 80-3; A J Baldwin and J A L Gunn, The Income Tax Laws of Australia (Sydney: Butterworth & Co, 1937), pp 271-7.

160. . See, to take the two most important examples, International Harvester Co of Canada Ltd v Provincial Tax Commission [1949] AC 36 (PC)and Provincial Treasurer of Manitoba v Wm Wrigley Jr Co Ltd [1950] AC 1 (PC).

161.
. Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306 (PC), Commissioner of Income Tax, Bombay Presidency and Aden v Chunilal B Mehta (1938) LR 65 IA 332 (PC).

162.
. Federal Commissioner of Taxation v Lewis Berger & Sons (Australia) Ltd (1927) 39 CLR 468,Commissioner of Taxation v Cam & Sons Ltd (1936) 36 NSWLR 544.

163.
. Nathan v Federal Commissioner of Taxation (1918) 25 CLR 183(dividends), Public Officer of the Studebaker Corporation of Australia Ltd v Commissioner of Taxation for New South Wales (1921) 29 CLR 225(interest), Commissioner of Taxes v Union Trustee Co of Australia Ltd [1931] AC 258(dividends), Premier Automatic Ticket Issuers Ltd v Federal Commissioner of Taxation (1933) 50 CLR 268(royalties), Commissioner of Taxation (New South Wales) v Premier Automatic Ticket Issuers Ltd (1933) 50 CLR 304(royalties), Tariff Reinsurances Ltd v Commissioner of Taxes (Victoria) (1938) 59 CLR 194(insurance premiums), Federal Commissioner of Taxation v United Aircraft Corporation (1943) 68 CLR 525(royalties). See also Commissioner of Inland Revenue v HK-TVB International Ltd [1992] 2 AC 397 (royalties) and Commissioner of Inland Revenue v Orion Caribbean Ltd (in voluntary liquidation) [1997] STC 923(interest).

164.
. Commissioner of Taxes v British United Shoe Machinery (SA) (Pty) Ltd (1964) 26 SATC 163. See also Inland RevenueOrdinance, s 15(1)(d).

165.
. International Harvester Co of Canada Ltd v Provincial Tax Commission [1949] AC 36, Provincial Treasurer of Manitoba v Wm Wrigley Jr Co Ltd [1950] AC 1, the BAWRA case [1931] AC 224, and Commissioner of Inland Revenue v Hang Seng Bank Ltd [1991] 1 AC 306.

166.
. See notes 47-62 above and the accompanying text.

167.
. In 1930 Australia abandoned the source principle of taxation in favour of residence. This effectively reduced the previously crucial question of apportionment to a matter of only peripheral significance.

168.
. See Littlewood (note 144 above).