Case No. D39/11

Case stated – profits tax – application to state case – section 69 of the Inland Revenue Ordinance ('IRO').

Panel: Colin Cohen (chairman), Arthur McInnis and Ng Man Sang Alan.

Date of hearing: No hearing.
Date of decision: 9 December 2011.

The Taxpayer contends that various moulds, used by the manufacturer in Country H are 'prescribed fixed asset' within the definition of section 16G(6) and the expenditure incurred by the Taxpayer on the provision of such moulds were *'specified capital expenditure'* and hence deductible.

By a Decision of this Board dated 23 August 2011 ('the Decision'), the Board dismissed the Taxpayer's appeal:

1. A capital expenditure is only deductible under section 16G if it is a *'specified capital expenditure'* within the meaning of section 16G(6), namely *'any capital expenditure incurred by the person on the provision of a prescribed fixed asset'*.

2. *'Prescribed fixed asset'* is defined in section 16G(6) to exclude an *'excluded fixed asset'*, that is *'a fixed asset in which any person holds rights as a lessee under a lease'*.

3. A *'lease'* is defined in section 2(1) to include *'any arrangement under which a right to use the machinery or plant is granted by the owner of the machinery or plant to another person'*.

4. The wording utilized in section 2(1) is unequivocal and clear and when the word *'include'* is used in an interpretation clause of a statute to define a word or phrase, it is ordinarily used to enlarge or expand on the ordinary meaning of the word or phrase.

5. There is no basis to ignore the statutory definition of a *'lease'* and instead apply an ordinary or technical meaning to the word set out in section 16G.

6. The arrangement between the Taxpayer and the manufacturer in Country H under which the Taxpayer allowed the manufacturer in Country H to use the moulds to produce the Taxpayer's products, falls unequivocally within the

definition of a '*lease*' as provided in section 2(1).

7. The moulds used by the Taxpayer's manufacturer in Country H were therefore *'excluded fixed assets'* within the definition in section 16G(6).

The Taxpayer then applied to the Board to state a case and the question of law raised for the opinion of the Court of First Instance is:

'*Did the Board err in law in their construction of section 16G of the Ordinance and in failing to conclude that section 16G rendered the expenditure concerned deductible expenditure for the purposes of the ascertainment of the Taxpayer's assessable profits in the years of assessment concerned?*'

Application allowed.

Stated Case:

Case stated pursuant to section 69 of the Inland Revenue Ordinance, Chapter 112 ('the Ordinance') by the Board of Review ('the Board') on the application of Company A (Region B) Limited ('the Taxpayer') for the opinion of the Court of First Instance.

Background to the appeal

1. At a hearing before the Board held on 28 June 2011, the Taxpayer appealed against the Determination of the Acting Deputy Commissioner of Inland Revenue dated 12 February 2010 in respect of Additional Profits Tax Assessments raised on the Taxpayer whereby:

'(1) Additional Profits Tax assessment for the year of assessment 2000/01 under Charge Number X-XXXXXXX-XX-X, dated 29 March 2007, showing additional Assessable Profits of $11,433,102 with additional Tax Payable thereon of HK$1,829,296 is hereby increased to additional Assessable Profits of $11,435,252 with additional Tax Payable thereon of $1,829,640.

(2) Additional Profits Tax assessment for the year of assessment 2001/02 under Charge Number X-XXXXXXX-XX-X, dated 10 January 2008, showing additional Assessable Profits of $3,806,307 with additional Tax Payable thereon of HK$609,010 is hereby reduced to additional Assessable Profits of $3,377,865 with additional Tax Payable thereon of $540,459.

(3) Additional Profits Tax assessment for the year of assessment 2002/03 under Charge Number X-XXXXXXX-XX-X, dated 10 January 2008, showing additional Assessable Profits of $4,810,332 with additional Tax Payable

> thereon of HK$769,654 is hereby reduced to additional Assessable Profits of $4,606,332 with additional Tax Payable thereon of $737,014.'

2. By its Decision dated 23 August 2011 ('the Decision'), the Board ruled in favour of the Commissioner of Inland Revenue (the 'CIR') and dismissed the Taxpayer's appeal. A copy of the Decision is annexed hereto and marked **ANNEXURE A**.

The agreed facts

3. The parties agreed a Statement of Agreed Facts, which the Board found as facts at paragraph 3 of the Decision.

The grounds of appeal

4. By prior notice the Taxpayer raised the grounds of appeal described in paragraph 2 of the Decision.

The Taxpayer's arguments

5. Before the Board, the Taxpayer made the written submissions annexed hereto and marked **ANNEXURE B**.

The CIR's arguments

6. Before the Board, the CIR made the written submissions annexed hereto and marked **ANNEXURE C**.

Question of law

7. The question of law raised for the opinion of the Court of First Instance is:

> Did the Board err in law in their construction of section 16G of the Ordinance and in failing to conclude that section 16G rendered the expenditure concerned deductible expenditure for the purposes of the ascertainment of the Taxpayer's assessable profits in the years of assessment concerned?

ANNEXURE A
D18/11

BOARD OF REVIEW

Appeal by the Appellant

(Date of Hearing: 28 June 2011)

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DECISION

****

Case No. D18/11

Profits tax – deductions – prescribed fixed assets – excluded fixed assets – plastic moulds used by another company at the permission of the Taxpayer – whether the permission amounted to a lease of the plastic moulds under the Inland Revenue Ordinance ('IRO') – sections 2, 16, 16G and 17 of the IRO.

Panel: Colin Cohen (chairman), Arthur McInnis and Ng Man Sang Alan.

Date of hearing: 28 June 2011.
Date of decision: 23 August 2011.

The Taxpayer engaged in the supply of plastic products and packaging materials, mass-produced from moulds manufactured by another company, Company C. The Taxpayer permitted Company C to use the moulds for the latter's production of the plastic products on the Taxpayer's behalf. The moulds were kept by Company C for the Taxpayer. In the material years of assessment, the Taxpayer claimed capital expenditure deductions of the cost of producing the moulds, treating the same as prescribed fixed assets. The Taxpayer also claimed deductions for royalty income received, arguing they were earned offshore. The Assessor, except to allow deductions of the proceeds on disposal of the moulds, rejected the claim for deductions and raised additional assessments. The Taxpayer refused to accept the revised additional assessment raised by the Assessor. The claim for deduction of the royalty income was subsequently withdrawn by the Taxpayer.

Held:

1. Section 17 of the IRO provides that no deduction shall be made for capital expenditure for the purpose of calculating the assessable profits under section 16. This is subject to the provisions of section 16G, which allows deduction for any specified capital expenditure incurred on any prescribed fixed assets. There is no dispute that plastic moulds fall within prescribed fixed assets as defined under section 16G, provided that they are not excluded fixed assets. As defined in section 16G(6), excluded fixed assets means fixed assets in which any person holds rights as a lessee under a lease. Lease is defined in section 2 to include, in relation to any machinery or plant, any arrangement under which a right to use the same is granted by the owner.

2. The term 'lease' in section 16G(6) must be construed based on the meaning defined in section 2 of the IRO, but not on its ordinary or legal meaning as submitted by the Taxpayer. There is no basis to ignore the statutory definition of a 'lease' in the IRO because it is unequivocal and clear in

enlarging the ordinary meaning of the word by using 'include' in the interpretation clause (Dilworth v Commissioner of Stamps [1899] AC 99; Thomas v Marshall [1953] AC 543; Penny's Bay Investment Co Ltd v Director of Lands FACV 8/2009, 26.03.2010 applied). This is so even though in practice it may be very difficult under any circumstances for any taxpayer to take advantage of the deductions.

3. Previous cases decided by the Board of Review has also construed the word 'lease' according to the statutory meaning rather than its ordinary and legal meaning (D61/08, (2009-10) IRBRD, vol 24, 184; D19/09, (2009-10) IRBRD, vol 24, 483 applied).

4. On the facts, it is not disputed that there is an arrangement under which a right to use the plastic moulds was granted by the Taxpayer to Company C. Thus, the plastic moulds were 'excluded fixed assets' within the definition of section 16G(6), and the capital expenditure incurred by the Taxpayer on the provision of the same fell outside section 16G.

Appeal dismissed.

Cases referred to:

Peterson v CIR [2005] STC 448 (PC)
HKSAR v Cheung Kwun Yin (2009) 12 HKCFAR 565
Medical Council of Hong Kong v Chow Siu Shek (2000) 3 HKCFAR 144
Director of Lands v Yin Shuen Enterprises Ltd (2003) 6 HKCFAR 1
PCCW-HKT Telephone Ltd v Telecommunications Authority (2005) 8 HKCFAR 337
Dilworth v Commissioner of Stamps [1899] AC 99
Thomas v Marshall [1953] AC 543 [(FACV 8/09, 26.3.2010)]
Penny's Bay Investment Co Ltd v Director of Lands
D61/08, (2009-10) IRBRD, vol 24, 184
D19/09, (2009-10) IRBRD, vol 24, 483

Barrie Barlow SC instructed by PricewaterhouseCoopers Limited for the Taxpayer.
Eugene Fung Counsel instructed by Department of Justice, Fong Wai Hang Freda and Leung Wing Chi for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal by Company A (Region B) Limited ('the Taxpayer') against the Acting Deputy Commissioner of Inland Revenue's determination dated 12 February 2010 ('the determination'). The determination was as follows:

> ' (1) Additional Profits Tax assessment for the year of assessment 2000/01 under Charge Number X-XXXXXXX-XX-X, dated 29 March 2007, showing additional Assessable Profits of $11,433,102 with additional Tax Payable thereon of HK$1,829,296 is hereby increased to additional Assessable Profits of $11,435,252 with additional Tax Payable thereon of $1,829,640.
>
> (2) Additional Profits Tax assessment for the year of assessment 2001/02 under Charge Number X-XXXXXXX-XX-X, dated 10 January 2008, showing additional Assessable Profits of $3,806,307 with additional Tax Payable thereon of HK$609,010 is hereby reduced to additional Assessable Profits of $3,377,865 with additional Tax Payable thereon of $540,459.
>
> (3) Additional Profits Tax assessment for the year of assessment 2002/03 under Charge Number X-XXXXXXX-XX-X, dated 10 January 2008, showing additional Assessable Profits of $4,810,332 with additional Tax Payable thereon of HK$769,654 is hereby reduced to additional Assessable Profits of $4,606,332 with additional Tax Payable thereon of $737,014.'

2. On 10 March 2010, the Taxpayer's representatives, PricewaterhouseCoopers Limited ('the Tax Representatives') filed the following grounds of appeal:

> ' 1. The Commissioner erred in law in his construction of the relevant provisions of the IRO.
>
> 2. In particular, the Commissioner erred in law in his construction of "lease" under sections 2 and 16G of the IRO.
>
> 3. The Commissioner also erred in disregarding the fact that the underlying plant and machinery was used in the production of the Appellant's profits chargeable to profits tax.'

Agreed facts

3. The following facts were agreed by the parties and we find them as facts:

(1) The Taxpayer has objected to the additional profits tax assessments for the years of assessment 2000/01 to 2002/03 raised on it. The Taxpayer claims that it was entitled to deduction of expenditures on prescribed fixed assets in respect of the moulds used by its suppliers outside Hong Kong. The Taxpayer also claimed (but subsequently withdrew that claim) that the royalty income it received was offshore in nature.

(2) The Taxpayer was incorporated in Hong Kong as a private company on 25 March 1988. In its profits tax returns, the Taxpayer declared its principal activity as 'supply of plastic [Product Y] and packaging materials'. The Taxpayer ceased its business on 1 July 2002.

(3) In the profits tax returns for the years of assessment 2000/01 to 2002/03, supported by audited financial statements and profits tax computations for the period ended 30 June 2000 and for the years ended 30 June 2001 and 2002, the Taxpayer reported amongst other things the following profits, income and expenditure:

Year of assessment	2000/01	2001/02	2002/03
	$	$	$
(a) Assessable profits	33,457,609	59,113,981	43,037,506
(b) Prescribed fixed assets – Moulds			
(i) Cost claimed as deductible	11,082,700	3,292,183	4,270,470
(ii) Sales proceeds offered for assessment	0	517,500	204,000
(c) Royalty income not chargeable to tax	350,402	514,124	539,862

In accordance with the assessable profits returned, the Assessor, in January and July 2003, raised on the Taxpayer profits tax assessments for the years of assessment 2000/01 to 2002/03. The Taxpayer did not object to these assessments.

(4) Messrs Deloitte Touche Tohmatsu ('Deloitte'), the Taxpayer's former tax representative, provided, among others, copies of the following documents:

(a) Exclusive Product Y Supply Agreement with Company C [Deloitte asserted that Appendices A and B to this agreement could not be located due to the passage of time].

(b) Supply agreement with Company D.

(c) An analysis of the moulds provided to the suppliers for the years of assessment 2000/01 to 2002/03.

(d) An analysis of the moulds used by Company C for the period from 4 January 1999 to 31 May 2002.

(e) Confirmation letter dated 8 June 2007 from Company C confirming that the moulds held by Company C belonged to the Taxpayer and that they were not treated as assets of Company C.

(5) The Assessor was not satisfied that the expenditures on provision of moulds were deductible under section 16G of the Inland Revenue Ordinance or that the royalty income was derived outside Hong Kong. She raised, in March 2007 and January 2008, on the Taxpayer the following additional profits tax assessments for the years of assessment 2000/01 to 2002/03:

	2000/01	2001/02	2002/03
	$	$	$
Profits per return	33,457,609	59,113,981	43,037,506
Add:			
Deduction of expenditure on moulds	11,082,700	3,292,183	4,270,470
Royalty income	350,402	514,124	539,862
Assessable profits	44,890,711	62,920,288	47,847,838
Less:			
Profits already assessed	33,457,609	59,113,981	43,037,506
Additional assessable profits	11,433,102	3,806,307	4,810,332
Additional tax payable thereon	1,829,296	609,010	769,654

(6) On behalf of the Taxpayer, Deloitte objected to the additional profits tax assessments for the years of assessment 2000/01 to 2002/03 on the grounds that the royalty income was offshore in nature [this ground was subsequently withdrawn, see Fact (8) below] and that the Taxpayer should be entitled to 100% deduction for the moulds.

(7) The Assessor maintained the view that the royalty income was sourced in Hong Kong and that the deduction of expenditure on prescribed fixed assets should not be allowed. The Assessor, however, was prepared to exclude the sale proceeds from disposal of moulds which were purchased by the Taxpayer in years of assessment 2000/01 and onwards where the expenditure claim for deduction under section 16G was denied. By a letter dated 22 May 2008, the Assessor proposed to revise the additional profits tax assessments for the years of assessment 2000/01 to 2002/03 as follows:

Year of assessment	2000/01	2001/02	2002/03
	$	$	$
Profits per return	33,457,609	59,113,981	43,037,506
Add:			
Royalty income	350,402	514,124	539,862
Deduction of expenditure on moulds	11,082,700	3,292,183	4,270,470
Moulds included in cost of sales	2,150[1]	-	-
	44,892,861	62,920,288	47,847,838
Less:			
Proceeds on disposal of moulds	-	428,442[2]	204,000[2]
Assessable profits	44,892,861	62,491,846	47,643,838
Less:			
Profits already assessed	33,457,609	59,113,981	43,037,506
Additional assessable profits	11,435,252	3,377,865	4,606,332
Additional tax payable thereon	1,829,640	540,459	737,014

Notes: [1] Moulds supplied to Company D
[2] Sale proceeds of assets for which deduction under section 16G had been claimed but disallowed previously

(8) The Taxpayer through its present Tax Representatives PricewaterhouseCoopers Limited did not accept the Assessor's proposal (although the royalty income issue was subsequently withdrawn).

Evidence

4. The Taxpayer called two witnesses, Mr E and Mr F. These witnesses had previously filed witness statements. Mr Eugene Fung ('Mr Fung') on behalf of the Inland Revenue Department ('IRD') did not cross-examine either witness.

Mr E

5. Mr E signed a witness statement dated 8 June 2011. He confirmed that the contents of his statement were correct. He told us that he was employed by the Taxpayer as a production controller. He explained that he was responsible for production scheduling.

6. He advised us that Company A (Country G) Limited (Company AG) solicited various retailers in Country G and then referred the orders from the retailers to the Taxpayer in respect of the mass production of Product Y.

7. He gave evidence as to how the designs prices, etc were agreed and how matters then progressed. He also told us that Company AG would register the design of Product Y by way of patents in Country G in order to protect the relevant interest of both the retailers and what he terms the 'Group of Company A' as a whole.

8. He told us about the unique nature of the design of the respective Product Y. He would communicate with Company AG to understand in detail the retailers' needs and requirements. He advised us that Company C was an independent mould manufacturer.

9. He would communicate with them in respect of the production of moulds and discuss the fee proposal for each mould which he in turn would look at and forward to Company AG.

10. Once the fee was agreed, Company C would prepare the drawings or design for producing the mould on behalf of the Taxpayer for the manufacturing of the specified Product Y.

11. He confirmed that Company C who manufactured the moulds for the Taxpayer were only allowed to use the moulds as instructed by them, that is solely to produce the Taxpayer's products having regard to their unique specifications. He told us that the moulds were provided by the Taxpayer as part of the contractual arrangements with their respective suppliers so as to ensure that they could produce Product Y to the exact specifications required. As the Product Y that were produced were specific to their customers' needs and bore Company A's trademark, these products would ultimately be used by retailers in Country G.

Mr F

12. Mr F was one of the two proprietors of Company C.

13. He was engaged in the business of mould design and production for the manufacturing of plastic products using mould injection techniques.

14. He told us that there was a factory in Country H ('Factory H'). He told us that Company C had been one of the major suppliers of Product Y for the Taxpayer since 1988. He would receive information as to the intended mould design from Company AG and the Taxpayer would send the drawings and the relevant design of Product Y to them. He would study the drawings and the relevant technical information and would revert to the Taxpayer with the design of the moulds based on the specifications given by Company AG to them through the Taxpayer.

15. Upon receipt of the approval from the Taxpayer, Company C would then manufacture the specified moulds in Factory H, and produce a few samples of Product Y for the Taxpayer's approval before launching into mass production.

16. For ease of logistics, the mould would not be physically transported to the Taxpayer but would be kept in Factory H for mass production to commence immediately upon receiving approval from the Taxpayer.

17. The moulds so produced were in fact used by Company C for the production of

Product Y solely for the Taxpayer.

18. He confirmed that all Product Y would bear Company A's trademark and therefore Company C was not able to produce any extra quantity and sell these to any other entities. He confirmed that Company C had never been given the ownership of the moulds, rather it had been allowed to use the moulds as instructed by the Taxpayer. He confirmed that the Taxpayer retained the title to the moulds.

19. Finally, he confirmed that most (if not all) of the moulds produced for the Taxpayer are now retained by them physically in Factory H.

20. Since there was no cross-examination, we have no hesitation in accepting the evidence both of Mr E and Mr F.

The issues

21. As can be seen, the Taxpayer is seeking to deduct its expenditure in relation to the various moulds, incurred in the relevant years of assessment from 2000/01 to 2002/03.

22. Clearly, the expenditure on moulds is in the nature of capital expenditure and the deduction of which is expressly disallowed by section 17(1)(c) of the Inland Revenue Ordinance (Chapter 112) ('IRO'). Yet, there are exceptions to the general rule. Section 16G of the IRO permits deduction of capital expenditure if certain conditions are satisfied.

23. One of these conditions is that the capital expenditure must have been incurred on a 'prescribed fixed asset' within the specified meaning of the IRO.

24. We accept that this is the only issue which the Board has to resolve. This is clearly a question of construction and therefore purely a question of law.

25. Indeed, Mr Barlow, SC, in his written points of reply, agreed that there consensually was a common ground between the parties upon the facts, upon the legislative history of the relevant sections, upon the principles of statutory construction, and upon the legislative purpose behind the enactment of section 16G. Therefore, he confirmed that the only real point between the parties is the usage within section 16G(6) of the term 'lease' within the definition (for the purposes of section 16G only) of 'excluded fixed assets'.

The relevant statutory provisions

26. Section 16 of the IRO provides as follows:

> '*(1) In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the*

production of profits in respect of which he is chargeable to tax under this Part for any period, including-

…..

(ga) the payments and expenditure specified in sections ….. 16G as provided therein; …..'

27. Section 16G of the IRO provides as follows:

'*(1) Notwithstanding anything in section 17, in ascertaining the profits of a person from any trade, profession or business in respect of which the person is chargeable to tax under this Part for any year of assessment, there shall, subject to subsections (2) and (3), be deducted any specified capital expenditure incurred by the person during the basis period for that year of assessment.*

(2) Where a prescribed fixed asset in respect of which any specified capital expenditure is incurred is used partly in the production of profits chargeable to tax under this Part and partly for any other purposes, the deduction allowable under this section shall be such part of the specified capital expenditure as is proportionate to the extent of the use of the asset in the production of the profits so chargeable to tax under this Part.

…..

(6) In this section–

"excluded fixed asset" means a fixed asset in which any person holds rights as a lessee under a lease;

"prescribed fixed asset" means–

(a) such of the machinery or plant specified in items ….. 26 ….. of the First Part of the Table annexed to rule 2 of the Inland Revenue Rules (Cap 112 sub. leg. A) as is used specifically and directly for any manufacturing process;

…..

but does not include an excluded fixed asset;

"specified capital expenditure", in relation to a person, means any capital expenditure incurred by the person on the provision of a prescribed fixed asset …..'

28. Section 17 of the IRO provides as follows:

> '(*1*) *For the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of–*
>
> …..
>
> *(c) any expenditure of a capital nature or any loss or withdrawal of capital;'*

29. The definition of the 'lease' is expressly provided in section 2 of the IRO and states as follows:

> *' "lease", in relation to any machinery or plant, includes–*
>
> *(a) any arrangement under which a right to use the machinery or plant is granted by the owner of the machinery or plant to another person; and*
>
> *(b) any arrangement under which a right to use the machinery or plant, being a right derived directly or indirectly from a right referred to in paragraph (a), is granted by a person to another person,*
>
> *but does not include a hire-purchase agreement or a conditional sale agreement unless, in the opinion of the Commissioner, the right under the agreement to purchase or obtain the property in the goods would reasonably be expected not to be exercised;'*

30. Item 26 of the First Part of the Table annexed to rule 2 of the Inland Revenue Rules ('IRR') refers to 'Plastic manufacturing machinery and plant including moulds'.

The Taxpayer's submissions

31. Mr Barlow, SC draws our attention to section 16(1) that requires that, in the ascertaining of chargeable profits, *'there shall be deducted all outgoings and expenses to the extent they are incurred ….. by such person in the production of [chargeable] profits …..'*. Hence, he argues that sections 16(1) and 17(1)(c) expressly preclude the deduction of expenditure of a capital nature in the ascertaining of the assessable profits.

32. However, he then draws our attention to section 16G that exempts certain specified capital expenditure from that general prohibition. He drew our attention to Peterson v CIR [2005] STC 448 (PC) where Lord Millet stated at page 459 as follows:

> '*[41] Before considering the effect of these features, their Lordships must say something about the purpose for which depreciation allowances are granted by Parliament. They are not specific to film financing but are of*

> *general application and have nothing to do with encouraging people to invest in films or indeed anything else. The statutory object in granting a depreciation allowance is to provide a tax equivalent to the normal accounting practice of writing off against profits the capital costs of acquiring an asset to be used for the purposes of a trade: see Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes) [2004] UKHL 51 at [39], [2005] STC 1 at [39], [2004] 3 WLR 1383 per Lord Nicholls of Birkenhead.'*

33. He asserts that section 16G contains a stand alone sub-regime of the IRO. He submits that section 16G overrides section 17 and section 16G has its own apportionment rule. He asserts that section 16G(6) defines *'specified capital expenditure'* as meaning (for the purpose of section 16G only) *'any capital expenditure incurred by the person on the provision of prescribed fixed asset …..'* unless the expenditure is deductible under another section of Part IV or the capital expenditure is incurred under a hire purchase agreement.

34. He asserts that section 16G(6) relevantly defines *'prescribed fixed asset'* as meaning (for the purposes of section 16G only) machinery or plant specified in the relevant Table annexed to rule 2 of the IRR as we have already stated above and that deals with plastic manufacturing machinery including moulds.

35. Section 16G(6) defines *'excluded fixed asset'* as meaning (for the purposes of section 16G only) *'a fixed asset in which any person holds rights as a lessee under a lease'*. He asserts there is no specific definition of *'lease'* within section 16G but he asserts that *'lease'* is a term of legal art and whether it is used in relation to land or as he asserts here in relation to a chattel, it means: a contractual entitlement to exclusive possession for a defined period of time.

36. However, section 2(1) of the IRO gives an exclusive definition of *'lease'* as set out above. Mr Barlow, SC argues that the extended inclusive definition creates a statutory fiction that an arrangement – whereunder a person other than the owner is permitted to use the machinery or plant – is a *'lease'* despite the fact that such arrangement is not a *'lease'* in law.

37. In short, he submits that the opening words of section 2(1) *'unless the context otherwise requires'* dictate that there must be a *'context'* for the primary or technical or ordinary usage of the term *'lease'* which he asserts is section 16G and elsewhere and a *'context'* for the extended or fictional usage of the term *'lease'* which he says is applicable to section 39E.

38. However, both parties agree that section 39E is not applicable to the appeal, although Mr Barlow, SC submits it is not irrelevant because it illustrates the engagement of the extended definition of *'lease'*.

39. In short, his argument is that this extended definition works within the specific anti-avoidance regime of section 39E in, as much as it provides, what he says, is 'efficacy'

or indeed 'potency' to the IRD's specific anti-avoidance powers.

40. Mr Barlow, SC's submission is that on the evidence and having regard to the general legal sense, there was no *'lease'* as one asserts in the general legal sense, that is meaning *'a contract by which the owner of an asset grants another person the right to the exclusive possession of the asset for a stated or ascertained period of time, usually in return for consideration'*. As such, he asserts there was no *'lease'* in the present case.

41. The definition of *'lease'* in section 2 of the IRO must have been enacted only in the context of section 39E of the IRO, that is to deal with and reduce tax avoidance or tax deferral by what is known as *'sale and leaseback'* or any other tax avoidance devices. Therefore, Mr Barlow, SC submits that *'lease'* should therefore be interpreted so it is consistent with the intent of the legislation.

General principles on statutory interpretation

42. There was considerable emphasis by the parties in their written submissions and in referring to the cases which they put before us as to the general principles on statutory interpretation which applied. However, in the end, there was little difference between the position taken by Mr Barlow, SC and Mr Fung as to those relevant principles and the legislative purpose behind the enactment of section 16G.

43. If required to choose between the submissions of counsel, we have no hesitation in accepting the submission put forward to us by Mr Fung as to the applicable general principles on statutory interpretation. We can summarize these as follows:

(a) In interpreting a statute, the court's task is to ascertain the intention of the legislature as expressed in the language of the statute. This is an objective exercise. We accept that the court is not engaged in an exercise of ascertaining the legislative intent on its own (see HKSAR v Cheung Kwun Yin (2009) 12 HKCFAR 565 at paragraph 11 (Li CJ)).

(b) We accept that the modern approach is to adopt a purposive interpretation. The statutory language is construed, having regard to its context and purpose. Words are given their natural and ordinary meaning unless the context or purpose points to a different meaning. Context and purpose are considered when interpreting the words used and not only when an ambiguity may be thought to arise.

(c) We accept that it is also necessary to read all of the relevant provisions together and in the context of the whole statute as a purposive unity in its appropriate legal and social setting (see Medical Council of Hong Kong v Chow Siu Shek (2000) 3 HKCFAR 144 at 154B-C).

(d) The purpose of a statutory provision may be evident from the provision itself. It may be ascertained from the Explanatory Memorandum to the

Bill, or from statements made by responsible officials of the Government in relation to a Bill in the Legislative Council (see Director of Lands v Yin Shuen Enterprises Ltd (2003) 6 HKCFAR 1 at paragraphs 21 and 22 (Lord Millett NPJ), PCCW-HKT Telephone Ltd v Telecommunications Authority (2005) 8 HKCFAR 337 at paragraph 20 (Bokhary PJ) and Cheung Kwun Yin (above at paragraph 14 (Li CJ)).

The Commissioner's position

44. Mr Fung submits that the IRD contends that the capital expenditures incurred by the Taxpayer on the moulds during the relevant years of assessment were not deductible for the following reasons:

(a) He asserts that the Taxpayer's expenditures on moulds were capital in nature and would therefore prima facie be disallowed under section 17(1)(c) of the IRO.

(b) The Taxpayer could not rely on the section 16G exceptions to section 17(1)(c) because of the following:

(1) There was an agreement under which a right to use the moulds was granted by the Taxpayer to another person, namely the manufacturer in Country H. He relies on the undisputed evidence given by Mr E and Mr F.

(2) He asserts that the arrangement in (a) above fell clearly and unequivocally within the definition of a *'lease'* in section 2 of the IRO.

(3) He asserts that the moulds were therefore *'excluded fixed assets'* within the definition of section 16G(6), namely fixed assets in which any person held rights as a lessee under a lease.

(4) He asserts therefore that by virtue of being *'excluded fixed assets'*, the moulds used by the manufacturer in Country H were not *'prescribed fixed assets'* within the definition of section 16G(6).

(5) He asserts that the moulds used by the manufacturer in Country H were not *'prescribed fixed assets'*, the capital expenditures incurred by the Taxpayer on the provision of them were not *'specified capital expenditure'* within the definition of section 16G(6).

(6) Therefore, the capital expenditures incurred by the Taxpayer on the provision of the moulds used by the manufacturer in the Mainland fell outside section 16G of the IRO.

45. Mr Fung draws to the Board's attention very strict and precise provisions set out in the IRO which deal with the way in which deductions can be claimed.

46. In respect of capital expenditure, he asserts that these are severely limited due to the specific terms of section 16G and as such, the Taxpayer can only come within the provisions in very limited circumstances.

47. He concludes that it is unequivocal that there was a lease arrangement between the Taxpayer and the manufacturer in Country H and as such, this falls squarely within the definitional section provided by section 2.

48. In his submissions, Mr Fung submits that the purpose of section 16G is to allow a taxpayer to claim deductions of a new head of capital expenditures as he asserts under the specific statutorily-defined *'prescribed fixed asset'* which would otherwise be disallowed by section 17(1)(c).

Discussion

49. We accept that a capital expenditure is only deductible under section 16G if it is a *'specified capital expenditure'* within the meaning of section 16G(6), namely *'any capital expenditure incurred by the person on the provision of a prescribed fixed asset'*.

50. In our view, it is quite clear that a *'prescribed fixed asset'* is defined in section 16G(6) to exclude an *'excluded fixed asset'*, that is *'a fixed asset in which any person holds rights as a lessee under a lease'*.

51. We have no difficulties in coming to the conclusion that a *'lease'* is defined in section 2(1) to include *'any arrangement under which a right to use the machinery or plant is granted by the owner of the machinery or plant to another person'*.

52. Hence, we accept that if the Taxpayer as in this case granted a right under any arrangement to use the moulds to another person and that the Taxpayer incurred capital expenditures on the provision of the moulds, such capital expenditures will not be a *'specified capital expenditure'* within the meaning of section 16G and no deduction can be made.

53. We have no difficulties also in holding that '*lease'* should not be given its ordinary or technical meaning in section 16G. We reject Mr Barlow, SC's submissions that '*lease'* should be given its ordinary or legal meaning.

54. We take the view that there is no basis for us to ignore the statutory definition of a *'lease'* and instead apply an ordinary or technical meaning to the word set out in section 16G.

55. Again, *'lease'* as we have previously stated is statutorily defined in section 2(1)

of the IRO. The word *'lease'* is defined by a definition in the interpretation clause in section 2(1) and to *'include'*, amongst other things, *'any arrangement under which a right to use the machinery or plant is granted by the owner of the machinery or plant to another person'*.

56. The wording utilized in section 2(1) is unequivocal and clear and we accept that when the word *'include'* is used in an interpretation clause of a statute to define a word or phrase, it is ordinarily used to enlarge or expand on the ordinary meaning of the word or phrase.

57. We rely on Dilworth v Commissioner of Stamps [1899] AC 99; Thomas v Marshall [1953] AC 543 and Penny's Bay Investment Co Ltd v Director of Lands (FACV 8/09, 26.3.2010). In Penny's Bay Investment Co Ltd v Director of Lands, Lord Hoffman stated at paragraph 38 as follows:

> *'When Parliamentary draftsman says that a term shall "include" something, he means that in addition to the terms having its ordinary, conventional meaning, it shall be deemed also to cover other things which might not be regarded as coming within that meaning.'*

58. We also have had the opportunity to consider two previous decisions of the Board of Review which have construed the word *'lease'* according to the statutory meaning rather than its ordinary or legal meaning. In particular we refer to D61/08, (2009-10) IRBRD, vol 24, 184 where the Board stated at paragraph 47 as follows:

> *'For the purpose of the IRO, the term 'lease' is defined widely ….. In our view, the IRO provides a broader meaning to the term than either its ordinary meaning or its legal definition in land law. An arrangement, which is not necessarily in writing, suffices.'*

59. We also rely on D19/09, (2009-10) IRBRD, vol 24, 483 at paragraph 49.

60. In our analysis, it is quite clear that the Taxpayer's expenditures on the moulds were capital in nature and would not be allowed to be deducted under section 17(1)(c) of the IRO.

61. In our view, there was quite clearly an arrangement under which a right to use the moulds was granted by the Taxpayer to the manufacturer in Country H.

62. Hence, having regard to the unequivocal and incontrovertible evidence that was never challenged, there was clearly an arrangement between the Taxpayer and the manufacturer in Country H under which the Taxpayer allowed the manufacturer in Country H to use the moulds to produce the Taxpayer's products.

63. In our view, looking at this matter as a whole, we take the view that the arrangement set out in the agreed facts and in the evidence of Mr E and Mr F, quite clearly

falls unequivocally within the definition of a '*lease*' as provided in section 2 of the IRO.

64. Therefore, in our analysis, the moulds used by the Taxpayer's manufacturer in Country H were therefore '*excluded fixed assets*' within the definition in section 16G(6), namely fixed assets in which any person holds rights as a lessee under a lease. Hence, the capital expenditures incurred by the Taxpayer on the provision of the moulds used by the manufacturer in Country H fell outside section 16G of the IRO.

65. We have given very careful consideration to Mr Barlow, SC's submissions on the legislative context of section 16G, the purpose for which it was enacted and that it is unrelated to tax avoidance schemes and devices which are covered by section 39E. It may be the case that it will be very difficult under any circumstances for any taxpayer to take advantage of the extended definition which Mr Fung puts forward but in our view, this extended definition is the correct interpretation of section 16G. The tax statutes here in Hong Kong are simple and straightforward and perhaps prevent and limit the impact of the efficacy of section 16G.

66. We are of the view that the appeal must be dismissed

67. Finally, we wish to take this opportunity of thanking the parties for their assistance in respect of this matter.

ANNEXURE B

IN THE INLAND REVENUE BOARD OF REVIEW

BETWEEN:

COMPANY A (REGION B) LIMITED Appellant

AND

COMMISSIONER OF INLAND REVENUE Respondent

Outline Final Address of Counsel for the Appellant/Taxpayer

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1. The Evidence

1.1. The Taxpayer relies upon the following evidence:

(a) The Statement of Agreed Facts.

(b) The evidence of Mr E.

(c) The evidence of Mr F.

(d) The Taxpayer's documentary evidence.

1.2. The Taxpayer contends that that evidence clearly establishes the following matters:

(a) During the years of assessment under appeal (2000/01 to 2002/03), the business of the Taxpayer was the manufacture of Product Y and packaging materials to the order of major retailers in Country G under the licence of intellectual property rights held by a related company (viz Company A (Country G) Limited) and by the use of industrial moulds made up pursuant thereto.

(b) As the principal operations of that business were carried on in Hong Kong, the Taxpayer returned the assessable profits of that business for the assessment of Hong Kong profits tax.

(c) The creation of the industrial moulds and their utilisation within the manufacturing processes was an indispensable part of the Taxpayer's business, without which none of the assessable profits concerned would have arisen.

(d) The moulds were created for the Taxpayer, at the Taxpayer's expense and they have been the exclusive property of the Taxpayer throughout.

(e) The utilisation of the moulds within the manufacture of Product Y (etc) was carried out by the two unrelated contract manufacturers (Company C and Company D), who produced the finished products which the Taxpayer acquired from the two contract manufacturers for sale to the Taxpayer's customers.

(f) Although the Taxpayer's staff guided the manufacturing processes and provided technical assistance in relation to the manufacturing of the finished products, those products were in substance manufactured by the two contract manufacturers, using (pursuant to a licence from the Taxpayer), the Taxpayer's industrial moulds, in the contract manufacturers' factories in Country H.

(g) The two contract manufacturers possessed and used the Taxpayer's industrial moulds pursuant to the Taxpayer's permission or licence to do so and as the Taxpayer's baillees of the Taxpayer's industrial moulds.

(h) In particular, there was no chattels lease in respect of the industrial moulds.

(i) Additionally, no sale and leaseback arrangement was involved and no leveraged lease transaction was involved.

(j) The arrangements between the Taxpayer and its two contract manufacturers included a right which was granted by the Taxpayer to each contract manufacturer to use the Taxpayer's industrial moulds in the manufacture of the finished products which had been ordered by the Taxpayer.

(k) By the time that he made his 12 February 2010 Determination, the Acting Deputy Commissioner of Inland Revenue was aware of these matters.

2. Principles of statutory construction

2.1. The Taxpayer relies upon the following established principles of statutory construction:

(a) Statutes are to be construed contextually and purposively, for example

(i) Medical Council of Hong Kong v Chow Siu Shek (2000) 3 HKCFAR 144 per Bokhary, PJ (construing a disciplinary provision in the Medical Registration Ordinance) at 154B-C:

'When the true position under a statute is to be ascertained by interpretation, it is necessary to read all of the relevant provisions together and in the context of the whole statute as a purposive unity in its appropriate legal and social setting. Furthermore it is necessary to identify the interpretative considerations involved and then, if they conflict, to weigh and balance them.'

(ii) HKSAR v Cheung Kwun Yin (2009) HKCFAR 568 per Li, CJ (construing a penal provision in the Theft Ordinance) at 574G-H and 575B:

'12. The modern approach is to adopt a purposive interpretation. The statutory language is construed, having regard to its context and purpose. Words are given their natural and ordinary meaning unless the context or purpose points to a different meaning. Context and purpose are considered when interpreting the words used and not only when an ambiguity may be thought to arise.'

'13. The context of a statutory provision should be taken in its widest sense and certainly includes the other provisions of the statute and the existing state of the law. See Town Planning Board v Society for the Protection of the Harbour Ltd at p. 13 I-J and Attorney-General v Prince Ernest Augustus of Hanover [1957] AC 436 at p. 461.'

(b) In the construction of any statute, it is the enacting provisions (that is the body of the enactment, as opposed to a definition section or sub-section) that is paramount, for example Jobbins v Middlesex CC [1949] 1 KB 142 per Scott, LJ at 160 and 161:

'If there is any ambiguity in the sub-section – indeed, I go further – unless there is absolutely clear language having the opposite effect, and there was no such language, prima facie that subsection [a definition section] *ought to be construed as not cutting down the operative provisions of the*

Act which are contained in section 3, and sub-s I, and s. 8, sub-ss 1 and 2(a) for those provisions are enacting provisions of the Act, conferring a right to superannuation. Compared to them a definition sub-section ought not to be treated as prima-facie an operative sub-section. It is a definition sub-section and no more'

(c) Definition sub-sections (once deprecated by the Courts) should never purport to *'enact under the guise of definition'*, for example:

Craies: Statute Law (7th Edn) pages 212 to 214.

(d) Within a definition sub-section, words of limitation, such as:

'*In this Ordinance, unless the context otherwise requires …'* must be given effect. One of the effects of such words of limitation is to render the definition **expressly** subservient to the enacting provisions. Consequently, if *"the context"*(that is the enacting provisions in the body of the Ordinance) *"otherwise requires"*, then the definition must yield to that context.

(e) A definition sub-section which extends the primary or ordinary meaning of a word by the use of the word *'including'* must always be placed within its correct context within the statute, for example:

(i) Craies on Statute Law (7th ed): page 214.

(ii) Commissioner of Customs and Excise v Savoy Hotel Ltd [1966] 1 WLR 948 per Sachs, J at 954D-F:

''*"Including" is a word to which parliamentary draftsmen seem considerably addicted: one reason for this may be that in law it can have, according to its context, not only one or other of simple but in essence quite differing effects (for instance, in relation to the words that follow it may be found to have been used simply to enlarge, to limit, to define exhaustively or for the avoidance of doubts to repeat the preceding word or phrase), but it may also be used to secure on one and the same occasion more than one of those effects, thus putting the draftsman, but not necessarily the court, in a happy position.'*

(iii) CIR v County Shipping Co Ltd [1990] 2 HKLR 400 per Fuad, V-P at 406I-407B:

> '*In my judgment, it is quite wrong to attempt to construe what is meant by the word "including" without looking at the context in which it is used. It may be that this is where the Board went wrong for, as we have seen, they seem to have approached the task before them from the stand that "This appeal depends entirely upon the interpretation of the word "including" where it appears in s. 16(1)" (paragraph 7(i) of the stated case). Moreover, much later in the case (paragraph 7(xx)) the Board said that they could find nothing ambiguous about the word "including" in s. 16(1). They noted that the word appeared in other sections of which s. 2, the definition section was one. The Board then said: "To hold that the word "including" in s. 16(1) should have a different meaning to the same word in other parts of the same Ordinance would require the plainest possible language."*'

(f) Save where otherwise expressly required by the statute, words are to be given their primary meaning, including technical terms (whose primary meaning is their technical meaning), for example:

(i) Mason v Bolton's Library Ltd [1913] 1 KB 83 per Farwell LJ (construing the legal term '*interpleader issue ordered*') at 90:

> '*The proviso is expressed in terms of art; technical phrases are used. It is a stringent rule of construction that in construing an Act of Parliament or a deed containing technical words, those words must be given their technical meaning.*'

(ii) Maunsell v Olins [1975] AC 373 per Lord Simon (construing the word '*premises')* at 391A-C:

> '*I. The "golden" rule of construction*
>
> *What Maxwell on Interpretation of Statutes, 12th ed. (1969), p. 28, calls "the first and most elementary rule of construction"*
>
> *"is that it is to be assumed that the words and phrases of technical legislation are used in their technical meaning if they have acquired one, and otherwise in their ordinary meaning."*
>
> *"This "golden" canon of construction has been so frequently and authoritatively stated that further citation would be otiose. It is sometimes put that, in statutes dealing with ordinary people in their everyday lives, the language is presumed to be used in its primary ordinary sense, unless*

> *this stultifies the purpose of the statute, or otherwise produces some injustice, absurdity, anomaly or contradiction, in which case some secondary ordinary sense may be preferred, so as to obviate the injustice, absurdity, anomaly or contradiction, or fulfil the purpose of the statute: while, in statutes dealing with technical matters, words which are capable of both bearing an ordinary meaning and being terms of art in the technical matter of the legislation will presumptively bear their primary meaning as such terms of art (or, if they must necessarily be modified, some secondary meaning as terms of art).”’*
> (emphasis added)

2.2. The Taxpayer contends that those principles apply to all Ordinances, including the Inland Revenue Ordinance, Chapter 112 (the ‘Ordinance’), albeit, as our Court of Final Appeal have pointed out[1], the applicability of the individual principles needs to be weighed and balanced in any particular case.

2.3. The Taxpayer further contends that the overall purpose of the Ordinance is to fund the workings of the HKSAR Government by exacting specific forms of taxes, from the classes of taxpayers identified therein, in accordance with the statutory regimes enacted therein. In respect of the Ordinance’s profits tax regime, Part IV of the Ordinance incorporates three core objects, viz: (a) uniformity that is **all** profits taxpayers are to be subject to the same statutory regime; (b) fairness and neutrality, that is the Ordinance is not to be enforced in a way that would incorporate some profits taxpayers being treated differently from others; and (c) symmetry that is the process of ascertainment of assessable profits requires that the true net balance be identified by the deduction of the expenditure which was incurred in the production of the assessable profits, from the gross taxable receipts which *inter alia* resulted from that expenditure.

3. The Ordinance

3.1. The Ordinance imposes, through Part IV, a charge to tax upon the assessable profits of every business carried on in Hong Kong insofar as those assessable profits arise in or derive from Hong Kong – section 14.

3.2. ‘Assessable profits’ is defined as meaning *‘the profits in respect of which a person is chargeable to tax for the basis period for any year of assessment, calculated in accordance with the provisions of Part IV.’*

3.3. The term *‘calculated in accordance with the provisions of Part IV’* primarily embraces sections 14 to 18F, whereby the assessable profits (sections 14 and 18 to 18F) are the balance which is obtained from deducting the mandatory deductions (sections 16 to 17, including section 16G) from the taxable trading receipts (sections 14 to 15E).

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[1] For example paragraph 2.1(a)(i) above.

3.4. Section 16(1) requires that, in the ascertainment of the chargeable profits, *'there **shall** be deducted all outgoings and expenses to the extent they are incurred … by such person in the production of* [chargeable] *profits …'* (emphasis added). Section 16(1) impliedly and section 17(1)(c) expressly – preclude the deduction of expenditure of a capital nature in the ascertainment of the assessable profits.

3.5. However, section 16G exempts certain specified capital expenditure from that general prohibition. The reason for that was explained by Lord Millet in Peterson v CIR [2005] STC 448 (PC) at 459:

> '*[41] Before considering the effect of these features, their Lordships must say something about the purpose for which depreciation allowances are granted by Parliament. They are not specific to film financing but are of general application and have nothing to do with encouraging people to invest in films or indeed anything else. The statutory object in granting a depreciation allowance is to provide a tax equivalent to the normal accounting practice of writing off against profits the capital costs of acquiring an asset to be used for the purposes of a trade: see Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes) [2004] UKHL 51 at [39], [2005] STC 1 at [39], [2004] 3 WLR 1383 per Lord Nicholls of Birkenhead.'*
> (emphasis added)

3.6. Section 16G[2] contains a stand alone sub-regime of the Ordinance, wherein: Section 16G overrides section 17 (section 16G(1)); section 16G has its own apportionment rule (section 16G(2)); section 16G overrides part of section 14 in order to mandate the inclusion of the proceeds of sale of particular capital assets as deemed trading receipts (section 16G(3)); section 16G has its own transitional provisions (section 16G(4)); and section 16G has its own definitions provisions for the purposes of section 16G only (sections 16G(5) and (6)).

3.7. Section 16G(1) mandates:

> '*(1) Notwithstanding anything in section 17, in ascertaining the profits of a person from any trade, profession or business in respect of which the person is chargeable to tax under this Part for any year of assessment, there shall, subject to subsections (2) and (3), be deducted any specified capital expenditure incurred by the person during the basis period for that year of assessment.'*
> (emphasis added)

[2] Like other provisions in the Ordinance, for example section 61A.

3.8. Section 16G(6) defines *'specified capital expenditure'* as meaning (for the purposes of s. 16G only) *'any capital expenditure incurred by the person*[3] *on the provision of a prescribed fixed asset …'* unless the expenditure is deductible under another section of Part IV or the capital expenditure is incurred under a hire purchase agreement.

3.9. Section 16G(6) relevantly defines *'prescribed fixed asset'* as meaning (for the purposes of section 16G only) *'machinery or plant specified in* [9] *items* [including] *… 26 … of the First Part of the Table annexed to rule 2 of the* [Ordinance's] *Inland Revenue Rules … as is used specifically and directly for any manufacturing process … but does not include any excluded fixed asset.'*

3.10. Within rule 2 of the Inland Revenue Rules, item 26 of the First Part of the Table is:

> *' 26. Plastic manufacturing machinery including moulds.'*

3.11. Section 16G(6) defines *'excluded fixed asset'* as meaning (<u>for the purposes of section 16G only</u>) *'a fixed asset in which any person <u>holds rights as a lessee</u> <u>under a lease</u>.'* (emphasis added).

3.12. There is <u>no</u> section 16G specific definition of lease within section 16G.

3.13. However the term *'lease'* is a legal term of art[4] and whether it is used in relation to land or (as here) in relation to a chattel, it means: a contractual entitlement to exclusive possession for a defined period of time, for example <u>The Oxford Dictionary of Law</u> (5th ed): *'lease'* (c/f *'licence'*). In ordinary usage the term has the same meaning.

3.14. Section 2(1) of the Ordinance contains an extended (inclusive) definition of *'lease'*, viz:

> *' (1) In this Ordinance, **<u>unless the context otherwise requires</u>** – …*
>
> *"lease" (租約), in relation to any machinery or plant, includes –*
>
> *(a) any arrangement under which a right to use the machinery or plant is granted by the owner of the machinery or plant to another person; and*
>
> *(b) any arrangement under which a right to use the machinery or plant, being a right derived directly or indirectly from a right referred to in paragraph (a), is granted by a person to another person, but does not include a hire-purchase agreement or a conditional sale agreement unless, in the opinion of the*

[3] That is: the taxpayer.

[4] As is the phrase *'interpleader issue ordered'* – see paragraph 2.1(f)(i) above.

> *Commissioner, the right under the agreement to purchase or obtain the property in the goods would reasonably be expected not to be exercised.'*
> (emphasis added)

3.15. *'Machinery or plant'* is not defined in section 2.

3.16. Where it is applicable, that extended inclusive definition creates a statutory fiction, viz the fiction that an arrangement (which would include a non-contractual arrangement, such as a gratuitous bailment) whereunder a person other than the owner is permitted to use the machinery or plant – is a 'lease' despite such an arrangement **not** being a lease in law (that is **not** being a lease within the primary meaning of that legal term of art, which is its technical meaning) and **not** being within the plain or ordinary usage of the term.[5]

3.17. Importantly, the adoption within section 2 of this inclusive form of definition **necessarily** requires that:

(a) within the Ordinance there is/are usage(s) of the term in its primary or technical meaning (which happens to align with its plain and ordinary meaning); **and**

(b) within the Ordinance there is/are usage(s) of the term in its extended or fictional meaning otherwise, the use of the inclusive definition would be futile or non-sensical.

3.18. As the definition sub-section itself **expressly** requires, the incorporation of one usage or the other is mandated by the **context** in which the term is used within the Ordinance.

3.19. It is submitted that *'the context'* of section 16G mandates the primary usage of the term and excludes the extended or fictional usage because:

(a) section 16G is a self-contained separate and largely independent sub-regime of the Ordinance;

(b) section 16G is concerned with capital expenditure upon fixed assets (which is far more extensive than just machinery or plant); and

(c) the section 16G specific definition of *'excluded fixed asset'* defines that term as **meaning** (which is **not** optional c/f *'including'* which **is** optional) and **only** meaning a fixed asset *'in which any person*[6] ***holds rights***

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5 See paragraph 3.13 above.

6 Meaning the taxpayer – see sections 14 to 18.

[meaning enforceable legal rights] ***as a lessee*** *under a lease'* – which does not arise in the case of the extended or fictional usage of the term.

3.20. Section 2's extended or fictional usage **is** mandated by the context of section 39E of the Ordinance, which confers upon the Commissioner of Inland Revenue ('CIR') statutory powers pursuant to the specific **anti-avoidance** provisions[7] of section 39E (which **is** concerned with '*machinery or plant*') which, as is recognized in the Determination herein, is **not** relevant to these assessments.

3.21. Any residual doubt about the scope of section 16G is clarified by:

(a) The Explanatory Memorandum[8] to the Inland Revenue (Amendment) (No. 2) Bill 1998 paragraph 4[9] (concerning clause 9 – which enacted section 16G); and

(b) the speech of the Secretary for the Treasury in moving the amended 1998 Bill in LegCo[10] at pages 212 to 213 concerning clause 9 (which became section 16G)

– namely the provision of a new head of mandatory deduction for expenditure on a '*prescribed fixed asset'* including machinery and plant related to manufacturing processes by providing a 100% immediate write-off for such expenditure.

3.22. The purpose of section 39E is clear from:

(a) Section 39E itself;

(b) the 1986 Bill (wherein the extended definitions of '*arrangement'*, '*conditional sale agreement'* and '*lease'* were originally brought into the Ordinance;

(c) the Financial Secretary's LegCo Brief on the Inland Revenue (Amendment) Bill 1986 pages 4 to 5 concerning clause 7;

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7 The engagement of statutory fictions within anti-avoidance provisions is not unusual for example section 61A(2)(a) of the Ordinance; Peterson v CIR [2005] STC 448 per Lord Millet at 450e-f and 451c-e.

8 Which has always been a permissible extrinsic guide to the purpose of the enactment for example Director of Lands v Yin Shuen Enterprises Ltd (2003) 6 HKCFAR 1 per Lord Millet, NPJ at 15; PCCW-HK Telephone Ltd v Telecommunications Authority (2005) 8 HKCFAR 337 per Bokhary, PJ at 351F; and HKSAR v Cheung Kwun Yin (2009) 12 HKCFAR 568 per Li, CJ at 577C-E.

9 The Explanatory Memorandum does not address the miscellaneous amendments to section 2 (clause 3 of the Bill) – which are all referable to the section 39E regime.

10 Which, where the Pepper v Hart preconditions are met, is now also a permissible extrinsic reference to identify the purpose of the enactment for example PCCW-HK Telephone Ltd v Telecommunications Authority (2005) 8 HKCFAR 337 per Bokhary, PJ at 351G-352G; HKSAR v Cheung Kwun Yin (2009) 12 HKCFAR 568 per Li, CJ at 575-576.

(d) the speech of the Financial Secretary moving the first reading of the 1986 Bill page 553; and

(e) the speech of the Financial Secretary moving the second reading of the 1986 Bill pages 741 to 742.

– namely to equip the CIR with general powers (section 61A) and with specific powers (section 39E) to combat tax avoidance schemes, in particular (insofar as section 39E is concerned) tax avoidance schemes involving the sale and leaseback or the leveraged leasing of machinery or plant. Throughout, the CIR has publicly relied upon that construction of section 39E – see DIPN No. 15.

3.23. Thus, where expenditure is incurred in the production of chargeable profits by the acquisition of a qualifying fixed asset (such as a plastic manufacturing mould) and that expenditure does not arise as part of a tax avoidance transaction (such as sale and leaseback or leveraged leasing), then that expenditure is subject to the mandatory deduction required by section 16G, within the ascertainment of the assessable profits which are subject to the section 14 charge.

3.24. As will be clear (from the authorities canvassed in footnote 10 herein), the Pepper v Hart principle does **not** relax the prohibition against reliance upon extrinsic materials for the purpose of statutory construction beyond the limited circumstances stipulated in that case, for example PCCW-HK Telephone Ltd at 352A-G. Thus **all** of the four items which have improperly been placed within cannot legitimately assist with any question of statutory construction. The Board is invited formally to rule that those items are not permissible extrinsic aids to the construction of the sections in issue here.

4. The Acting Deputy Commissioner of Inland Revenue's mis-analysis

4.1. As can be seen from his reasons in the Determination, the Acting Deputy Commissioner of Inland Revenue's analysis:

(a) was predicated upon a construction of the Ordinance which incorrectly assumes (using the same flawed logic as that which was strongly criticized by our Court of Appeal in CIR v County Shipping[11]) that the extended or fictional usage within the section 2 definition of *'lease'* applies to the usage of that term within the (section 16G specific) definition of *'excluded fixed asset'* in section 16G(6);

(b) was **not** predicated upon there being any actual lease in fact;

[11] See paragraph 2.1(e)(iii) above.

(c) was influenced by two wholly irrelevant decisions of the Board[12]; and

(d) was **not** predicated upon any actual or suspected tax avoidance arrangements (such as sale and leaseback or leveraged leases) that is section 39E is wholly irrelevant.

4.2. The Taxpayer contends that the first three elements of the Acting Deputy Commissioner of Inland Revenue's analysis (that is paragraph 4.1(a) to (c) above) are erroneous because:

(a) the *'context'* of section 16G engages the primary usage which is preserved within the section 2 definition of *'lease'* and excludes the extended or fictional usage;

(b) with all due respect to the gentleman, the Acting Deputy Commissioner of Inland Revenue's analysis is simplistic and an invitation to this Board to repeat the errors made by the Board in CIR v County Shipping Co Ltd – see paragraph 2.1(e)(iii) above;

(c) LegCo enacted section 16G in order to provide general relief to Hong Kong taxpayers who genuinely (and not artificially) incurred expenditure upon the acquisition of manufacturing fixed assets within the production of their chargeable profits,[13] save where such expenditure was deductible under some other provision of the Ordinance;

(d) that enactment was consistent with one of the core features of Part IV of the Ordinance, namely symmetry within the process of ascertaining assessable profits, by matching the deductibility of expenditure incurred in the production of the chargeable profits, with the taxable receipts;

(e) in 1986 LegCo enacted section 39E together with the extended definitions of *'arrangement'*, *'conditional sale agreement'* and *'lease'*[14] for the purpose of extending the powers of the CIR to raise anti-avoidance assessments in order to counter-act tax avoidance schemes, including transactions involving sale and leaseback and leveraged leases; and

(f) that enactment was consistent with the Ordinance's policy of equipping the CIR with statutory powers in appropriate cases to raise anti-avoidance assessments so as to counteract transactions entered into

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12 Namely D61/08, (2009-10) IRBRD, vol 24, 184 and D19/09, (2009-10) IRBRD, vol 24, 483.

13 See paragraph 3.5 above.

14 Which later (in 1998) and for reasons which the Financial Secretary did not explain these were moved from section 39E to section 2(1) of the Ordinance – where, unlike their original 'home' (section 39(5)), the ambit of the extended definition was restricted by the introductory words of section 2(1).

in order to avoid, defer or reduce the incidence of liability to pay profits tax.

4.3. Thus, the Board should annul the Additional Profits Tax Assessments pursuant to section 68(8)(a) of the Ordinance, because they are based upon a misconstruction of section 16G of the Ordinance.

5. The CIR's powers

5.1. Additionally and alternatively, the Acting Deputy Commissioner of Inland Revenue has acted in excess of the CIR's powers under the Ordinance.

5.2. The requirements of section 16G are mandatory and self-executing. They leave no residual power or discretion to the CIR, insofar as the making of assessments or the determination of assessments-under-objection are concerned.

5.3. The requirements of section 16G allow no scope for departmental policy in relation to their applicability c/f paragraph 3(5) of the Determination.

5.4. Should the Board conclude that the Acting Deputy Commissioner of Inland Revenue's Determination was guided by a departmental policy,[15] then his *ultra vires* Determination should also be annulled pursuant to section 68(8)(a) of the Ordinance – see Harley Development Inc v CIR [1996] 1 WLR 727 per Lord Jauncey at 735F to 736C.

Barrie Barlow, SC
Counsel for the Appellant/Taxpayer
28 June 2011

[15] And note paragraph 1.2(k) above.

IN THE INLAND REVENUE BOARD OF REVIEW

BETWEEN:

COMPANY A (REGION B) LIMITED Appellant

AND

COMMISSIONER OF INLAND REVENUE Respondent

Taxpayer's Points of Reply

"Paragraphs" = paragraphs of submissions for CIR

1. There is a lot of common ground between the parties: upon the facts; upon the legislative history of the relevant sections; (generally) upon the relevant principles of statutory construction; and upon the legislative purpose behind the enactment of section 16G.

2. The only real point of departure between the parties is the usage within section 16G(6) of the term *'lease'* within the definition (for the purposes of section 16G only) of *'excluded fixed asset'* – see paragraphs 16, 27 and 49.

3. The Taxpayer contends (paragraphs 3.17 to 3.23) that the opening words of section 2(1) plus the nature of the extended section 2(1) definition of *'lease'* dictate that, within the Ordinance, there must be a *'context'* for the primary or technical or ordinary usage of the term '*lease'* (which we say is section 16G and elsewhere) and a 'context' for the extended or fictional usage of the term *'lease'* (which we say is section 39E).

4. The Commissioner of Inland Revenue ('CIR') contends (like the Acting Deputy Commissioner of Inland Revenue in the Determination) that the usage within the section 16G(6) definition of *'excluded fixed asset'* of the term *'lease'* is defined in section 2 and that the *'context'* of section 16G does not exclude that definition.

5. The Taxpayer contends that, when one considers: the legislative context of section 16G; the purpose for which it was enacted; the fact that it is unrelated to tax avoidance schemes/devices (which are covered by section 39E); plus the fact (illustrated by the Board's dialogue with Mr Fung) that the adoption of the extended definition would probably rob section 16G of all efficacy (and defeat the legislative object for which it was enacted) – the *'context'* of section 16G clearly does *'otherwise require'* .

6. Section 16G will work and achieve its legislative purpose if the primary meaning of *'lease'* is applied – if the extended or fictional meaning is applied, it will not.

7. Section 39E is inapplicable to this appeal. However, section 39E is not 'irrelevant' – because it illustrates the engagement of the extended definition (see paragraph 3.17 of my Outline). The extended definition works within the specific anti-avoidance regime within section 39E inasmuch as it provides efficacy (potency even) to the CIR's specific anti-avoidance powers therein.

8. To borrow from the CFA in the Medical Council case: the Taxpayer's construction makes the relevant sections of the Ordinance work as part of a *'purposive unity'* .

9. The CIR's construction does not.

10. Section 5 of my Outline does not arise.

Barrie Barlow, SC
Counsel for the Appellant/Taxpayer
28 June 2011

ANNEXURE C

For hearing before the Board of Review
on Tuesday, 28 June 2011

Company A (Region B) Limited v CIR

SUBMISSIONS FOR
COMMISSIONER OF INLAND REVENUE

References herein are to the following bundles before the Board:

A1	=	Taxpayer's bundle of documents
A2	=	Taxpayer's bundle of authorities
R1	=	Revenue's bundle of documents
R2	=	Revenue's bundle of authorities

Introduction

1. By the Determination dated 12 February 2010 ('the Determination'), the Acting Deputy Commissioner of Inland Revenue (1) increased the 2000/01 additional profits tax assessment and (2) reduced the 2001/02 and 2002/03 additional profits tax assessments, of the Taxpayer, Company A (Region B) Limited.

2. In this appeal, the Taxpayer seeks to deduct its expenditures in relation to some moulds incurred in 3 years of assessment from 2000/01 to 2002/03. Expenditures on moulds are in the nature of capital expenditures, the deduction of which is generally and expressly disallowed by section 17(1)(c) of the Inland Revenue Ordinance, Chapter 112 ('IRO'). There are, however, exceptions to this general rule, one of which is provided in sections 16G which permits deduction of capital expenditure if certain conditions are satisfied. One of these conditions is that the capital expenditure must have been incurred on a *'prescribed fixed asset'* within the specified meaning in the IRO. This is the only issue the Board has to resolve in this appeal. It is a question of construction and is therefore purely a question of law.

The background facts

3. The Commissioner of Inland Revenue ('CIR') respectfully invites the Board to adopt the facts set out in the Statement of Agreed Facts as the background facts in this appeal.

The grounds of appeal

4. By a Notice of Appeal dated 10 March 2010, the Taxpayer appealed to the Board of Review (the Board) against the Determination in respect of the years of assessment from 2000/01 to 2001/03 and the following three grounds of appeal are put forward:

(1) 'The [CIR] erred in law in his construction of the relevant provisions of the IRO.'

(2) 'In particular, the [CIR] erred in law in his construction of "lease" under sections 2 and 16G of the IRO.'

(3) 'The [CIR] also erred in disregarding the fact that the underlying plant and machinery was used in the production of the [Taxpayer's] profits chargeable to profits tax.'

5. From the Taxpayer's grounds of appeal, it is clear that no factual issues are raised in this appeal. As submitted earlier, the main issue to be dealt with by the Board is to ascertain the true construction of section 16G in the IRO to determine whether the Taxpayer should be allowed deduction of capital expenditures on the moulds in the relevant years of assessment.

The relevant statutory provisions

6. Section 16 of the IRO, relevantly, provides:

'*(1) In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period, including –*

…

(ga the payments and expenditure specified in sections ... 16G, as provided therein; ...'

7. Section 16G of the IRO, relevantly, provides:

'*(1) Notwithstanding anything in section 17, in ascertaining the profits of a person from any trade, profession or business in respect of which the person is chargeable to tax under this Part for any year of assessment, there shall ... be deducted any specified capital*

expenditure incurred by the person during the basis period for that year of assessment.

(2) Where a prescribed fixed asset in respect of which any specified capital expenditure is incurred is used partly in the production of profits chargeable to tax under this Part and partly for any other purposes, the deduction allowable under this section shall be such part of the specified capital expenditure as is proportionate to the extent of the use of the asset in the production of the profits so chargeable to tax under this Part.

...

(6) In this section -

"excluded fixed asset" means a fixed asset in which any person holds rights as a lessee under a lease;

"prescribed fixed asset" means

(a) such of the machinery or plant specified in items … 26 of the First Part of the Table annexed to rule 2 of the Inland Revenue Rules (Cap. 12 sub. leg. A) as is used specifically and directly for any manufacturing process;

...

but does not include an excluded fixed asset;

"specified capital expenditure", in relation to a person, means any capital expenditure incurred by the person on the provision of a prescribed fixed asset ... '

8. Section 17 of the IRO, relevantly, provides:

' (1) For the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of

…

(c) any expenditure of a capital nature or any loss or withdrawal of capital;'

9. The definition of 'lease' is expressly provided in section 2 of the IRO:

> ' *"lease", in relation to any machinery or plant, includes –*
>
> *(a) any arrangement under which a right to use the machinery or plant is granted by the owner of the machinery or plant to another person; and*
>
> *(b) any arrangement under which a right to use the machinery or plant, being a right derived directly or indirectly from a right referred to in paragraph (a), is granted by a person to another person,*
>
> *but does not include a hire-purchase agreement or a conditional sale agreement unless, in the opinion of the Commissioner, the right under the agreement to purchase or obtain the property in the goods would reasonably be expected not to be exercised;'*

10. Item 26 of the First Part of the Table annexed to Rule 2 of the Inland Revenue Rules refers to *'Plastic manufacturing machinery and plant including moulds'*.

Exhaustive scheme for deductions in the IRO

11. Sections 16 and 17 of the IRO provide **exhaustively** for deductions in the sense that:

(1) permitted deductions and confined to outgoings and expenses incurred in the production of profits in respect of which tax is chargeable (see section 16(1));

(2) such permitted deductions expressly **include** those specified in (a) to (h) of section 16(1); and

(3) such permitted deductions expressly **exclude** those in section 17.

See Lo & Lo v CIR (1984) 2 HKTC 34 at 71 (Lord Brightman).

12. The permitted deductions referred to in the opening paragraph of section 16(1) therefore represent only the general rule ('the General Rule'): see Lo & Lo (above) at 45 (Hunter J) and 58 (Leonard VP). Even if the General Rule is satisfied, a deduction cannot be allowed if it is excluded by any of the paragraphs in section 17.

13. In the present case, the Board is **not** concerned with the application of the General Rule. Expenditures incurred on moulds are capital in nature and are expressly disallowed to be deducted under section 17(1)(c) of the IRO (see paragraph 8 above). This is why the Taxpayer in the present case only seeks to rely on section 16G – a provision concerning with deduction of capital expenditure on the provision of a prescribed fixed asset – to obtain deduction of the expenditures incurred on the moulds.

14. Sections 16 and 16G of the IRO therefore provide a specifically-defined exception to the rule that expenditure of a capital nature is not deductible when computing a taxpayer's assessable profits. They provide that such capital expenditure may be deducted where the following two conditions are both satisfied:

(1) The capital expenditure is incurred during the basis period for that year of assessment by the taxpayer in the production of profits in respect of which he is chargeable to tax under Part IV. In the other words, the General Rule is engaged.

(2) The capital expenditure falls within the specified definition of *'specified capital expenditure'* in section 16G(6).

15. At this juncture, the Board can dispose of Ground 3 of the Taxpayer's appeal (see paragraph 4 above), which asserts that the CIR 'erred in disregarding the fact that the underlying plant and machinery was used in the production of the [Taxpayer's] profits chargeable to profits tax'.

(1) As explained above, the fact that the relevant plant and machinery was used in the production of a taxpayer's profits chargeable to profits tax is only relevant to the General Rule. It is only one of the two conditions to be satisfied for a capital expenditure to be deductible (see previous paragraph), and is not determinative of the question whether a capital expenditure is deductible or not under section 16G.

(2) In any event, it is incorrect to say that the CIR disregarded 'the fact that the underlying plant and machinery was used in the production of the [Taxpayer's] profits chargeable to profits tax'. As stated in paragraph 3(4) of the Determination, this fact was assumed in favour of the Taxpayer in the Determination.

The CIR's Position

16. For the following reasons, the CIR contends that the capital expenditures incurred by the Taxpayer on the moulds during the relevant years of assessment were **not** deductible.

(1) The Taxpayer's expenditures on the moulds were capital in nature and were therefore prima facie disallowed under section 17(1)(c) of the IRO.

(2) The Taxpayer could **not** rely on section 16G, the exception to section 17(1)(c), because of the following.

(a) There was an arrangement under which a right to use the moulds was granted by the Taxpayer to another person, namely the manufacturers in Country H: see paragraphs 8 and 9 of Statement

of Mr E and paragraph 10 of Statement of Mr F.

(b) The arrangement in (a) fell within the definition of a *'lease'* in section 2 of the IRO.

(c) The moulds were therefore *'excluded fixed assets'* within the definition in section 16G(6), namely fixed assets in which any person held rights as a lessee under a lease.

(d) By virtue of being *'excluded fixed assets'*, the moulds used by the manufacturers in Country H were not *'prescribed fixed assets'* within the definition in section 16G(6).

(e) As the moulds used by the manufacturers in Country H were not *'prescribed fixed assets'*, the capital expenditures incurred by the Taxpayer on the provision of them were not *'specified capital expenditure'* within the definition in section 16G(6).

(f) Accordingly, the capital expenditures incurred by the Taxpayer on the provision of the moulds used by the manufacturers in Country H fell outside section 16G of the IRO.

The Taxpayer's case

17. It is unclear how the Taxpayer intends to construe the relevant provisions in the IRO in this appeal to contend that its expenditures incurred on the moulds fell within section 16G. These submissions are prepared without the benefit of seeing the Taxpayer's submissions on how it construes section 16G.

18. However, from the previous correspondence between the Taxpayer's tax representatives and the IRD, as well as the authorities included in the Taxpayer's bundle of authorities, the CIR anticipates that the following contentions will be advanced by the Taxpayer in this appeal.

(1) A *'lease'* in the general legal sense means *'a contract by which the owner of an asset grants another person the right to the exclusive possession of the assets for a stated or ascertained period of time, usually in return for consideration'*. There was no such lease in the present case. See paragraph 1(8)(a) of Determination.

(2) The definition of *'lease'* in section 2 of the IRO was enacted in the context of section 39E of the IRO to curtail or to reduce tax avoidance or tax deferral by 'sale and leaseback' and by other tax avoidance devices. The term *'lease'* should therefore be interpreted so that it is consistent with the intent of the legislation. See paragraph 1(8)(c) of Determination.

CIR's submissions

General principles on statutory interpretation

19. The following general principles on statutory interpretation can be found in the CFA authorities cited by the Taxpayer and are accepted by the CIR.

(1) In interpreting a statute, the court's task is to ascertain the intention of the legislature as expressed in the language of the statute. This is an objective exercise. The court is not engaged in an exercise of ascertaining the legislative intent on its own. See HKSAR v Cheung Kwun Yin (2009) 12 HKCFAR 568 at paragraph 11 (Li CJ).

(2) The modern approach is to adopt a purposive interpretation. The statutory language is construed, having regard to its context and purpose. Words are given their natural and ordinary meaning unless the context or purpose points to a different meaning. Context and purpose are considered when interpreting the words used and not only when an ambiguity may be thought to arise. See Cheung Kwun Yin (above) at paragraph 12 (Li CJ).

(3) It is also necessary to read all of the relevant provisions together and in the context of the whole statute as a purposive unity in its appropriate legal and social setting. See Medical Council of Hong Kong v Chow Siu Shek (2000) 3 HKCFAR 144 at 154B-C (Bokhary PJ).

(4) The purpose of a statutory provision may be evident from the provision itself. It may also be ascertained from the Explanatory Memorandum to the bill, or from the statements made by the responsible official of the Government in relation to the bill in the Legislative Council. See Director of Lands v Yin Shuen Enterprises Ltd (2003) 6 HKCFAR 1 at paragraphs 21 to 22 (Lord Millett NPJ); PCCW-HKT Telephone Ltd v Telecommunications Authority (2005) 8 HKCFAR 337 at paragraph 20 (Bokhary PJ); Cheung Kwun Yin (above) at paragraph 14 (Li CJ).

Purpose and context of section 16G

20. As submitted in paragraph 19(4) above, the purpose of a statutory provision may be ascertained in different ways. It may be evident from the provision itself, or it may be ascertained from the Explanatory Memorandum to the bill, or from the explanations given by the responsible official in LegCo when the bill was introduced.

21. Section 16G:

(1) Section 16G is expressly referred to in section 16(1)(ga) as one of the instances of permitted deduction.

(2) Sections 16(1)(ga) and 16G are necessary to create an exception to the rule in section 17(1)(c) that *'any expenditure of a capital nature'* is disallowed to be deducted. This is recognized by the opening words of section 16G(1) which provide *'Notwithstanding anything in section 17 …'*.

(3) The purpose of section 16G is therefore tolerably clear. It is to allow a taxpayer to claim deductions of certain capital expenditures (namely deductions of expenditure on a statutorily-defined '*prescribed fixed asset*') which would otherwise be disallowed by section 17(1)(c).

22. Explanatory Memorandum to the bill:

(1) Section 16G was added to the IRO by clause 9 of the Inland Revenue (Amendment) (No 2) Bill 1998.

(2) Section 16(1)(ga) was amended by clause 6 of the Inland Revenue (Amendment) (No 2) Bill 1998 to expressly refer to section 16G.

(3) The Explanatory Memorandum of the Inland Revenue (Amendment) (No 2) Bill 1998 stated:

'The purpose of this Bill is to amend the Inland Revenue Ordinance (Cap. 112) to give effect to the proposals in the 1998-99 Budget.

2. The Bill, inter alia, amends the provisions relating to profits tax in Part IV of the principal Ordinance –

…

4. to add a new head for the deduction of expenditure on a 'prescribed fixed asset', which expression is defined to cover machinery and plant related to manufacturing processes as well as computer hardware and software, by providing for a 100% immediate write-off in respect of the expenditure (clause 9);'

(4) Accordingly, the purpose of section 16G is also spelt out in the Explanatory Bill, namely *'to add a new head for the deduction of expenditure on a "prescribed fixed asset"'*.

23. Explanations given at LegCo:

(1) From the Hansard of the Provisional LegCo of 7 April 1998, it can be seen that:

(a) the Inland Revenue (Amendment) (No 2) Bill 1998 was read the Second time without debate (page 210);

(b) the Secretary for the Treasury moved to have certain clauses in the Inland Revenue (Amendment) (No 2) Bill 1998 amended, including clause 9 (which was concerned with section 16G) (page 212);

(c) the amendments to clause 9 of the Bill were, however, not relevant to any issues in this appeal (pages 300 to 301);

(d) the Secretary for Treasury's explanation of the amendments to clause 9 was therefore also not relevant (pages 212 to 213).

(2) Accordingly, what the responsible official said in Provisional LegCo on the Inland Revenue (Amendment) (No 2) Bill 1998 does not throw any light on the purpose of section 16G.

24. From all of these sources, the CIR respectfully submits that the purpose of section 16G is to allow a taxpayer to claim deductions of a new head of capital expenditures (namely deductions of expenditure on a statutorily-defined '*prescribed fixed asset*') which would otherwise be disallowed by section 17(1)(c). This is the relevant context. The *'mischief rule'*, as referred to by Bokhary PJ at page 153D of Chow Siu Shek (above), therefore has no application in the construction of section 16G.

Section 39E not relevant

25. References have been made by the Taxpayer's tax representative to section 39E of the IRO and its purpose. The CIR respectfully submits that the purpose of section 16G cannot be ascertained from section 39E, or from the purpose of section 39E.

26. Section 39E was added to the IRO by clause 7 of the Inland Revenue (Amendment) Bill **1986**. In other words, it was added to the IRO some 12 years **before** section 16G was added.

27. The **only** common feature between section 16G and section 39E is that they share the same definition of the term *'lease'*.

(1) When section 39E was added to the IRO in 1986, the term *'lease'* was given a statutory definition in section 39E(5).

(2) When section 16G was added to the IRO in 1998, various definitions in the then section 39E(5), including the definition of *'lease'*, were repealed: see clause 24 of the Inland Revenue (Amendment) (No 2) Bill 1998.

(3) The same definition of *'lease'* was at the same time added to section 2(1) of the IRO: see clause 3 of the Inland Revenue (Amendment) (No 2) Bill 1998.

(4) Neither the Explanatory Memorandum of the Inland Revenue (Amendment) (No 2) Bill 1998 nor the Hansard reveal the purpose of the repeal of the definition of *'lease'* from section 39E, or the purpose of the introduction of the same definition in section 2(1) of the IRO.

(5) However, the absence of any explanation of purpose does **not** mean that the changes were made inadvertently, accidentally or for no reason.

(6) On the contrary, the fact that the definition of *'lease'* was moved to section 2 of the IRO in 1998 means that it was a clear and deliberate decision on the part of the legislature for the definitions in section 16G(6) to be subject to such a special definition of *'lease'*.

28. In the Taxpayer's bundle of authorities, extrinsic materials such as the Legislative Council Brief in relation to the Inland Revenue (Amendment) Bill 1986 and other Hansard materials have been included. It is unclear to what purpose such materials serve in this appeal in the construction of section 16G. The CIR respectfully reminds the Board of the three conditions laid down in Pepper v Hart [1993] AC 593 before resort could be made to legislative materials.

(1) In Pepper v Hart, Lord Browne-Wilkinson at 634C-F said that legislative materials can only be looked at if the following three conditions are satisfied:

(a) The relevant legislative provision had to be ambiguous or obscure or led to an absurdity.

(b) The material relied on consisted of one or more statements made by a minister or other promoter of the Bill together, if necessary, with such other material as might be necessary to understand such statements and their effect.

(c) The effect of such statement was clear.

These conditions were applied by Chan PJ in Registrar of Births and Deaths v Hussain (2001) 4 HKCFAR 429 at 444 A-C and Ma CJHC (as he then was) in Lam Kin Sum v Hong Kong Housing Authority [2005] 3

HKLRD 456 at 470B-F.

(2) The CIR respectfully submit that none of these conditions is satisfied in the present case in relation to section 16G and the Taxpayer therefore cannot rely on the extrinsic materials in to construe section 16G.

(3) For the sake of completeness, it should be mentioned that the application of these three conditions in Pepper v Hart is not inconsistent with the references to Explanatory Memorandum and the Government official's oral explanations at the LegCo: see Yin Shuen at paragraphs 21 and 22.

Meaning of 'lease' in section 16G

29. As submitted in paragraph 14 above, a capital expenditure is only deductible under section 16G if it is a *'specified capital expenditure'* within the meaning of section 16G(6), namely *'any capital expenditure incurred by the person on the provision of a prescribed fixed asset'*.

30. However, a *'prescribed fixed asset'* is defined in section 16G(6) to exclude an *'excluded fixed asset'*, namely *'a fixed asset in which any person holds rights as a lessee under a lease'*.

31. A *'lease'* is defined in section 2(1) to include *'any arrangement under which a right to use the machinery or plant is granted by the owner of the machinery or plant to another person'*.

32. In other words, if a taxpayer grants a right under any arrangement to use a mould to another person, and the taxpayer incurs capital expenditure on the provision of the mould, such capital expenditure will **not** be a *'specified capital expenditure'* within the meaning of section 16G and no deduction can be made.

'Lease' should not be given its ordinary or technical meaning in section 16G

33. The Taxpayer has suggested that the word 'lease' should be given its ordinary or legal meaning. It is unclear what the basis for this suggestion is. The CIR respectfully submits that there is no basis to ignore the statutory definition of *'lease'* and instead apply the ordinary or technical meaning of the word to section 16G.

(1) As a general rule, as pointed out by Li CJ in Cheung Kwun Yin (see paragraph 19(2) above), words in a statute are generally to be given their natural and ordinary meaning. See also Maunsell v Olins [1975] AC 373 at 382F (Lord Reid).

(2) Similarly, if the word ordinarily bears a technical meaning, such a word should be given its technical meaning by the courts. See Mason v Bolton's Library Ltd [1912] 1 KB 83 at 88, 90 and 92 (the technical

words being '*interpleader issue ordered*').

(3) However, as Li CJ expressly said so in Cheung Kwun Yin, '[w]*ords are given their natural and ordinary meaning* ***unless the context or purpose points to a different meaning***' [emphasis added]. The same must in principle extend to words which have technical meaning.

(4) Therefore, it must follow that if a word is given a special or enlarged meaning by the statute, then such special or enlarged meaning will prevail over its ordinary or technical meaning.

'Lease' is statutorily-defined in section 2(1) of the IRO

34. In the IRO, the word *'lease'* is defined by a definition or interpretation clause in section 2(1) to *'include'*, amongst other things, *'any arrangement under which a right to use the machinery or plant is granted by the owner of the machinery or plant to another person'*.

35. When the word *'include'* is used in an interpretation clause in a statute to define a word or phrase, it is ordinarily used to enlarge or expand the ordinary meaning of the word or phrase. See:

(1) In Dilworth v Commissioner of Stamps [1899] AC 99, Lord Watson at pages 105 to 106 said:

> '*The word "include" is very generally used in interpretation clauses in order to enlarge the meaning of words or phrases occurring in the body of the statute; and when it is so used these words or phrases must be construed as comprehending, not only such things as they signify according to their natural import, but also those things which the interpretation clause declares that they shall include.*'

(2) In Thomas v Marshall [1953] AC 543, the issue was whether the absolute gifts by a father to his infant and unmarried children in the form of money paid into Post Office Savings Bank accounts opened in their names were 'settlements' within section 21 of the Finance Act 1936 so as to render the father liable as settlor to pay income tax on the interest payable on the accounts. *'Settlement'* was defined in section 21(9)(b) to include *'any disposition, trust, covenant, agreement, arrangement or transfer of assets'*. The issue was resolved in the affirmative by Donovan J, the Court of Appeal and the House of Lords. At page 556, Lord Morton said:

> '*The object of the [subsection (9)(b)] is, surely, to make it plain that in section 21 the word "settlement" is to be enlarged to*

> *include other transactions would not be regarded as "settlement" within the meaning that word ordinarily bears.'*

(3) In Penny's Bay Investment Co Ltd v Directors of Lands (FACV 8/09, 26.3.2010), Lord Hoffmann NPJ at paragraph 38 said:

> *'When Parliamentary draftsman says that a term shall "include" something, he means that in addition to the term having its ordinary, conventional meaning, it shall be deemed also to cover other things which might not be regarded as coming within that meaning.'*

36. The application of an interpretation clause may bring about a result which would not otherwise have been brought. However, this should not have any influence on the courts in determining the true construction of the relevant statutory provision.

37. In Savoy Hotel Co v LCC [1900] 1 QB 665, the issue was whether Savoy Hotel was a *'shop'* within the meaning of the Shop Hours Act 1892, under which provision was made as to the number of hours in any one week during which young persons under 18 years of age might be employed in a shop. In the Act, *'shop'* was defined to include *'licensed public-houses and refreshment houses of any kind'*. The court held that Savoy Hotel, which had a public-house licence, was a *'shop'* within the meaning of the Act.

(1) At page 668, Channell J identified the object of the statute was *'to restrict the number of the hours of employment in shops of young persons under eighteen years of age'*.

(2) At page 669, Channell J said:

> *'The reason for legislating in this way is that the Legislature intended to bring within the Act something that otherwise would not be within it, but would nevertheless be within the mischief against which the Act was intended to provide. Neither a licensed public-house nor a refreshment house comes within the ordinary meaning of the word "shop"; but the Legislature were of the opinion that there were some public-houses and refreshment houses as much within the mischief sought to be guarded against as an ordinary shop. That being so, we ought not to give any importance to the fact that the Act appears to apply to establishments which one would have thought there would be no intention to include within its scope, for the result of an interpretation clause is frequently to bring the most incongruous things within the operation of a statute. … I think, therefore, that we are bound so to interpret the Act as to make it include the Savoy Hotel.'*

38. The Taxpayer has referred to a passage in Craies on Statute Law (7th ed, 1971) pages 213 to 214 presumably for some judicial criticisms of the use of interpretation clauses.

Be that as it may, courts certainly have no power to strike down or ignore interpretation clauses in legislation just because they do not like them. In any event, it should be noted the latest edition of Craies on Statute Law (9th ed, 2008) no longer contains such a passage.

39. In Lisbeth Enterprises Ltd v Mandy Luk (2006) 9 HKCFAR 131, Bokhary PJ recognized that disapproval and ill wishes had been judicially expressed about interpretation clauses. Nonetheless, his Lordship at paragraph 15 said:

> '*… interpretation clauses now form an established and important feature of our statute law. In Savoy Hotel … Channell J observed (at p.669) that "the result of an interpretation clause is frequently to bring the most incongruous things within the operation of a statute". Sometimes that is precisely what the Legislature intended – and for discernibly good policy reasons … the learned editors of Statutory Interpretation, one of them formerly First Parliamentary Counsel, observe that interpretation clauses "are responsible for a great deal of economy in drafting". The upshot, in my opinion, is that no useful purpose would be served by viewing interpretation clauses with hostility or suspicion. The proper approach is to read them purposefully and with the context very much in mind.'*

40. In Lisbeth, Bokhary PJ also said at paragraph 20 that *'[w]here a statute provides that a word or phrase shall have a particular meaning save where the context otherwise requires, a context in which that meaning would create an unworkable situation can properly be regarded as a context requiring some other meaning'*. There are two reasons why this statement does not assist the Taxpayer.

(1) First, the Taxpayer cannot properly identify any context in which it is justified to dis-apply the statutory definition of *'lease'* to section 16G. The purpose and context of section 16G is already set out in paragraphs 20 to 24 above.

(2) Moreover, it plainly does not create an unworkable situation if the statutory definition of *'lease'* is applied to section 16G. The only situation that arises from the application of the statutory definition of *'lease'* is a result which the Taxpayer does not like.

41. On two previous occasions, the Board of Review has construed the word *'lease'* according to the statutorily-defined meaning, rather than its ordinary or legal meaning. In D61/08, (2009-10) IRBRD, vol 24, 184, the Board (comprising Mr Chow Wai Shun, Mr Alan Ng and Ms Wendy Yung) at paragraph 47 said:

> '*For the purpose of the IRO, the term "lease" is defined widely … In our view, the IRO provides a broader meaning to the term than either its ordinary meaning or its legal definition in land law. An arrangement, which is not necessarily in writing, suffices.'*

See also D19/09, (2009-10) IRBRD, vol 24, 483 at paragraph 49.

42. The Taxpayer has referred to two other authorities involving the use of the word 'including'. Again, it is unclear how the Taxpayer intends to rely on these authorities. In any event, the CIR respectfully submits that these authorities provide no assistance to the Taxpayer.

43. In CCE v Savoy Hotel Ltd [1966] 1 WLR 948, the issue was whether natural juice extracted by hand from oranges for the use of particular persons as provided by the defendant at their hotels was *'manufactured beverages'* within the meaning of the Purchase Tax Act 1963. The orange juice would be subject to purchase tax if it fell within goup 35 of part 1 of schedule 1 to the Act, which was defined as *'Group 35. (a) Manufactured beverages, including fruit juices and bottled waters, and syrups, concentrates, essences, powders, crystals or other products for the preparation of beverages…'*

(1) At page 954D-F, Sachs J held that the word 'including' can have differing effects in different contexts. He said:

> *'"Including" is a word to which parliamentary draftsmen seem considerably addicted: one reason for this may be that in law it can have, according to its context, not only one or other of simple but in essence quite differing effects (for instance, in relation to the words that follow it may be found to have been used simply to enlarge, to limit, to define exhaustively or for the avoidance of doubts to repeat the preceding word or phrase), but it may also be used to secure on one and the same occasion more than one of those effects, thus putting the draftsman, but not necessarily the court, in a happy position.'*

(2) In the end, Sachs J declined to hold that the word 'including' was intended to enlarge the definition of manufactured beverages so far as to encompass freshly squeezed orange juice. His Lordship held that the words *'manufactured beverages, including fruit juices'* included only fruit juices which could be described as manufactured beverages.

(3) Therefore, Sachs J construed the phrase after the word '*including*' as examples of the differing form of a manufactured beverage. In other words, the word *'including'* was construed to mean *'can take the manufacturing form in'* so that group 35(a) would read *'Manufactured beverages, [can take the manufacturing form in] fruit juices and bottled waters, and syrups, concentrates, essences, powders, crystals or other products for the preparation of beverages…'*

(4) This authority does **not** assist the Taxpayer. The issue in the case was whether portions of orange juice fell within group 35 of part I of schedule I of the Act (see page 952C). Sachs J was therefore concerned

> with the question of whether the natural juice extracted by hand could be '*manufactured beverages*'. Unlike the present case where there is a statutory definition of a 'lease', there was no statutory definition of the phrase '*manufactured beverages*' and the learned Judge therefore did not have to consider whether the juice extracted by hand fell within the statutory definition of '*manufactured beverages*'. In the end, he applied 'common sense' to come to the conclusion that freshly-squeezed orange juice could not be a form of '*manufactured beverage*' (see page 954H).

44. In CIR v County Shipping Co Ltd [1990] 2 HKLR 400, the Court of Appeal held that for interest on a debt incurred by the taxpayer to be deductible, he must satisfy both the requirements in the introductory words of section 16(1), that is the General Rule, as well as the conditions set out in sections 16(1)(a) and 16(2). The Court of Appeal at 407B-E referred to what Sachs J said in CCE v Savoy Hotel Ltd quoted in paragraph 43(1) above and said that the word 'including' in section 16(1) must be construed in its proper context (page 406H). The conclusion which the Court of Appeal reached was decided in the particular context. At page 408A-B, Fuad V-P said:

> '*I prefer to reject [the taxpayer's counsel's] elaborate submission in favour of a straightforward explanation for the presence of s. 16(2) – because s. 16(1)(a) makes it perfectly clear that where interest upon money borrowed for the purpose of producing profits in respect of which a person is chargeable to tax is sought to be deducted, it may be deducted if the provisions of one of the paragraphs of sub-s. (2) are satisfied but otherwise.*'

Accordingly, this case provides no assistance to the Taxpayer as to how the Board can dis-apply the statutory definition of the word 'lease' in the IRO in the present appeal.

Taxpayer cannot satisfy requirements of section 16G

45. In the present case, the following is common ground.

(1) The Taxpayer's expenditures on the moulds were capital in nature and would not be allowed to be deducted under section 17(1)(c) of the IRO.

(2) There were arrangements under which a right to use the moulds was granted by the Taxpayer to the manufacturers in Country H. See:

(a) In the Statement of Mr E (a former production controller of the Taxpayer), it was said that:

> '[the] suppliers (e.g. [Company C]) who manufactured the moulds for [the Taxpayer] were only, allowed to use the moulds as instructed by [the Taxpayer] (i.e. solely to produce [the Taxpayer's] products following [its] unique specifications and not otherwise.' [paragraph 8]

> ' The moulds were provided by [the Taxpayer] as part of the contractual arrangement with the suppliers (e.g. [Company C] or [Company D] and their affiliates) to ensure that they could produce the hangers in the exact specifications required.' [paragraph 9]

(b) Similarly, in paragraph 10 of Statement of Mr F (one of the two proprietors of Company C (a manufacturer)), it was said that:

> ' [Company C] … had been, and only been, allowed to use the moulds as instructed and agreed by [the Taxpayer] (i.e. solely to produce [the Taxpayer's] products following [its] unique specifications. … [Company C] was given rights stemming from [the Taxpayer's] strictly limited contractual licence to use the moulds.'

(c) In a document produced by the Taxpayer dated 8 June 2007, Company C confirmed that *'all tools [referred to in the 3-page list] are used solely in the production of the goods supplied to [the Taxpayer] …'*

(d) As recorded in paragraph 1(8)(b) of the Determination, the Taxpayer's tax representative had stated:

> '*…the suppliers had been, and only been, allowed to use the moulds in such a way that was instructed and agreed by the [Taxpayer] (i.e. solely to produce the [Taxpayer's] products following the [Taxpayer's] unique specifications) … the suppliers were given rights stem from the [Taxpayer's] strictly limited contractual <u>licence</u> to use the moulds.*' [emphasis used in the original text]

46. There was clearly an arrangement between the Taxpayer and the manufacturers under which the Taxpayer allowed the manufacturers to use the moulds to produce the Taxpayer's products. The Board is respectfully invited to make a finding of fact on this. This arrangement would clearly fall within the definition of a *'lease'* as provided in section 2 of the IRO.

47. Accordingly, the moulds used by the Taxpayer's manufacturers were therefore *'excluded fixed assets'* within the definition in section 16G(6), namely fixed assets in which any person holds rights as a lessee under a lease. By virtue of being *'excluded fixed assets'*, such moulds were not *'prescribed fixed assets'* within the definition in section 16G(6). As such, the capital expenditures incurred by the Taxpayer on the provision of such moulds were not *'specified capital expenditure'* within the definition in section 16G(6).

48. Therefore, the capital expenditures incurred by the Taxpayer on the provision of the moulds used by manufacturers in Country H fell outside section 16G of the IRO.

49. The only way in which the Taxpayer can succeed in this appeal is to ask the Board to ignore the statutory definition of *'lease'* in section 2 of the IRO, or to read it in a way so as to deprive it of its expanded meaning. This would render the statutory definition totally meaningless and is against a cardinal principle of statutory construction that the courts must endeavour to give significance to every word of an enactment. See:

(1) In Stone v Yeovil (1876) 1 CPD 691, Brett J at 701 said:

> *'It is a canon of construction that, if it be possible, effect must be given to every word of an Act of Parliament or other document; but that, if there be a word or phrase therein to which no sensible meaning can be given, it must be eliminated.'*

In the present case, it certainly cannot be said that no sensible meaning can be given to the statutory definition of *'lease'* in section 2 of the IRO.

(2) In The Commonwealth v Baume (1905) 2 CLR 405, Griffith CJ at 414 said that it was *'a known rule in the interpretation of Statutes that such a sense is to be made upon the whole as that no clause, sentence, or word shall prove superfluous, void, or insignificant, if by any other construction they may all be made useful and pertinent.'*

50. The courts cannot ignore the language used in the statutes in favour of a general resort to values. Sir Sydney Kentridge QC, when giving a judgment of the South African Constitutional Court in 1995, said:

> *'If the language used by the lawgiver is ignored in favour of a general resort to values the result is not interpretation but divination.'*

This was approved by Lord Hoffmann in the Privy Council and by Ma CJHC (as he then was) in Lam Kin Sum v Hong Kong Housing Authority [2005] 3 HKLRD 456 at 471F-G. Ma CJHC went further and said at 471G-H:

> *'Though different in nature, constitutions, statutes and ordinary contracts fall to be construed by the Courts in similar ways. The object of the exercise is to discover the meaning of the words actually used in the instrument. The Court's task is not to act as a legislator.'*

51. If the Board were to ignore the statutory definition of *'lease'* in the application of section 16G, the true meaning of the words actually used in sections 2 and 16G would have to be changed.

52. In the context of tax legislation, the Board is respectfully reminded of the

following well-known passage of Rowlatt J in Cape Brandy Syndicate v IRC [1921] 1 KB 64 at 71:

> '*… in a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing to be implied. One can only look fairly at the language used.*'

53. Essentially, the reality of the situation is this. The legislation has created exceptions to the general rule against deduction of capital expenditures. One of such exceptions is section 16G where capital expenditures on the provision of a prescribed fixed asset are incurred. This is the purpose and context of section 16G. However, section 16G imposes a very rigorous test. This was a deliberate decision by the legislature to exclude the situation where the relevant fixed asset was used by a third party and not the taxpayer himself. Such a deliberate decision is not absurd. Section 16G, together with the statutory definition of *'lease'* in section 2, simply amount to a rule. If the taxpayer does not fulfil the requirements of the rule, he does not qualify for the deduction of capital expenditure.

Conclusion

54. For all of the above reasons, it is submitted that this appeal must be dismissed.

28 June 2011.

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