IN THE SUPREME COURT OF HONG KONG

HIGH COURT

INLAND REVENUE APPEAL NO. 2 OF 1996

BETWEEN

COMMISSIONER OF INLAND REVENUE Appellant

and

NATIONAL MUTUAL CENTRE (HK) LTD. Respondent

Coram: The Hon. Mr. Justice Stone in Court

Dates of Hearing: 3rd, 4th and 5th February 1997

Date of Handing Down of Judgment: 25th March 1997

J U D G M E N T

This is an appeal by the Commissioner of Inland Revenue by way of Case Stated pursuant to s. 69(1) of the Inland Revenue Ordinance, Cap. 112 ("the Ordinance").

No material facts are in dispute, and the case boils down, as Miss Chung for the Commissioner and Mr. Kotewall Q.C. for the taxpayer both agree, to a pure question of construction of various provisions within s.16(1) and s.16(2)(c) of the Ordinance. If only to place the argument into context, however, a brief outline of the factual background may assist.

At all relevant times, the Respondent taxpayer (previously known as Bartlefield Ltd.) was engaged in property investment. In order to finance the purchase of a building in Hong Kong, to be renamed the "National Mutual Centre", the

Respondent borrowed the greater proportion of the purchase price from first, a consortium of banks and, second, from its ultimate parent company in Australia. For present purposes this was taken by both parties to the appeal to be the National Mutual Life Association of Australasia Ltd.

Accordingly, on 4th February 1987 the Respondent entered into three agreements: -

First, a Loan Agreement regulating the borrowing from the Banks;

Second, a Subordinated Loan Agreement between the Parent Company and the Respondent; and

Third, a Shareholders' Subordination Agreement between the Respondent, the Parent Company, and the Banks' Agent.

Reference will need to be made to certain aspects of the latter two Agreements in addressing the arguments raised in this appeal; for present purposes, however, suffice to say that the broad structure of the financing arrangements was that the primary indebtedness was to the consortium of lending banks, with the secondary debt being that due to the Parent Company, stated in the Agreements to be the "Subordinated Lender". The result of this arrangement was that whilst it was agreed that interest would accrue upon the secondary debt, the Subordinated Lender would not receive *any* monies in repayment prior to the date of final payment of the monies due to the Principal Lenders.

In short, whilst recognising the dangers inherent in descriptive compression, this arrangement may fairly be summarised as one of subordinated debt with deferred payment, and the nub of this case, which has developed in the manner I shall shortly outline, is whether, in the calculation of its profits for the years of assessment in question, it was open to the Respondent taxpayer legitimately to deduct sums in interest accruing due to its Parent, the Subordinated Lender, notwithstanding that, pursuant to the terms of the Agreements, that Parent was to receive nothing until satisfaction of the primary debt due to the Banks.

Although simply put, the point at issue is perhaps not as easily resolved, and the case which has arisen requires analysis of the relevant statutory provisions in the context of the Agreements described above. A complicating factor, if indeed such it be, was the enactment on 19th May 1989 of the Inland Revenue (No. 2) Ordinance, No. 17 of 1989, which took effect from the year of assessment 1989/90, and which removed the whole of Part V of the Ordinance relating to interest tax. Such repeal assumed some importance in the argument propounded on behalf of the Appellant, as I shall shortly describe.

But to return to the history of events. For the purpose of its assessment to profits tax, the purported deductions for and on behalf of the taxpayer of the sums in interest claimed to be incurred in the relevant years of assessment were disallowed by the Commissioner, pursuant to a Determination dated 24th December 1992. The assessments within this Determination, which form the subject matter of this appeal, are, in summary:

(i) The 1987/88 Profits Tax Assessment dated 13th September 1989;

(ii) The 1988/89 Profits Tax Assessment dated 13th September 1989;

(iii) The 1988/89 Additional Profits Tax Assessment dated 26th November 1990; and

(iv) The 1989/90 Additional Profits Tax Assessment dated 26th November 1990.

In broad terms, insofar as I am able to discern from the figures before me, the disallowance of the interest deductions claimed represented an increase in net assessable profits of in or about HK$400,000.00, and the taxpayer's appeal against these assessments was heard by the Inland Revenue Board of Review in April 1993.

By its written decision dated 26th October 1993 the Board allowed the appeal, and ordered the discharge of all four of the assessments in issue. The Board sought to apply the decisions of ***Lo & Lo v. CIR*** [1984] 2 HKTC 34 and ***CIR v. County Shipping Company Limited*** [1990] 3 HKTC 267 to the facts of this case, and concluded that for the purposes of its decision the interest expenses in question were "incurred" and "payable" within the meaning of section 16(1), and further that *at the material times* the sums payable by way of interest were chargeable to tax under the Ordinance by operation of the then section 28(1), and accordingly were deductible under section 16(2)(c).

Upon the application of the Commissioner of Inland Revenue, the Case Stated by the Board of Review issued on 10th January 1996, and contained five questions of law for the opinion of the High Court. In effect, however, and as counsel agreed, this appeal crystallises into three specific points:

First, was the interest claimed "incurred" by the taxpayer within the meaning of s.16(1);

Second, was the interest so claimed "payable" by the taxpayer within the meaning of s.16(1)(a); and

Third, was such interest "chargeable" to tax in the hands of the recipient within the meaning of s.16(2)(c).

In order to appreciate the way in which these terms fit into the relevant statutory framework, it may be convenient to reproduce at the outset the particular sections in question:

> "**16. Ascertainment of chargeable profits**
>
> (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 -
>
> (*a*) where the conditions set out in subsection (2) are satisfied, sums **payable** by such person by way of interest upon any money borrowed by him for the purpose of producing such profits, and sums payable by such person by way of legal fees, procuration fees, stamp duties and other expenses in connection with such borrowing;
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> .....
>
> (2) The conditions referred to in subsection (1)(*a*) are that -
>
> .....
>
> (*c*) the money has been borrowed from a person other than a financial institution or an overseas financial institution and the sums payable by way of interest are **chargeable** to tax under this Ordinance;
>
> ....."

Two further matters arise by way of introductory comment. First, I accept the submission of Miss Chung with regard to the role of the Court in relation to tax appeals: see the well-known observations of Lord Radcliffe in ***Edwards v. Bairstow and Harrison*** [1956] A.C. 14 at p.36:

> "I think that the true position of the court in all these cases can be shortly stated. If a party to a hearing before commissioners expresses dissatisfaction with their determination as being erroneous in point of law, it is for them to state a case and in the body of it to set out the facts that they have found as well as their determination. I do not think that inferences drawn

> from other facts are incapable of being themselves findings of fact, although there is value in the distinction between primary facts and inferences drawn from them. When the case comes before the court it is its duty to examine the determination having regard to its knowledge of the relevant law. If the case contains anything ex facie which is bad law and which bears upon the determination, it is, obviously, erroneous in point of law. But, without any such misconception appearing ex facie, it may be that the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. In those circumstances, too, the court must intervene. It has no option but to assume that there has been some misconception of the law and that this has been responsible for the determination. So there, too, there has been error in point of law. I do not think that it much matters whether this state of affairs is described as one in which there is no evidence to support the determination or as one in which the evidence is inconsistent with and contradictory of the determination, or as one in which the true and only reasonable conclusion contradicts the determination. Rightly understood, each phrase propounds the same test. For my part, I prefer the last of the three, since I think that it is rather misleading to speak of there being no evidence to support a conclusion when in cases such as these many of the facts are likely to be neutral in themselves, and only to take their colour from the combination of circumstances in which they are found to occur."

My attention has also been drawn to the useful observations of Barnett J. in ***CIR v. Inland Revenue Board of Review and Another***, [1989] 2 HKLR 40 at p. 57, where the learned judge succinctly summarises the position in relation to tax appeals, and the manner in which the conclusions of the Board of Review may be impugned.

Second, I am reluctant to unreservedly embrace Miss Chung's stricture against having due regard to decisions in other jurisdictions when construing particular words within our statutory provisions. Miss Chung was emphasising, I think, the danger in simply accepting or adopting interpretations which had been placed upon particular words in other jurisdictions without according due weight to the particular statutory framework of that jurisdiction. That is fair enough, but I can see no mileage

in accepting her invitation. in effect, to don an interpretational straitjacket. In this context, Mr. Kotewall Q.C. drew my attention to the approach adopted by Lord Hoffmann in the recent Privy Council decision in ***CIR v. Mitsubishi Motors New Zealand Ltd.*** [1996] 1 A.C. 315, in which the Board patently did not confine itself to a consideration of the particular New Zealand legislation at issue in that case but in fact also considered authorities in other jurisdictions, whilst recognising and placing into the balance the differences within individual statutory schemes.

With that introduction, I turn now to address the specific questions posed by the Board for the consideration of this Court.

(1) ***Whether the Board has erred in law in finding that the interest in question was incurred within Section 16(1) of the Inland Revenue Ordinance.***

The battle lines here seem to me to devolve primarily upon classification of the taxpayer's obligation under the Agreements it has entered into as opposed to any real disagreement as to the meaning of the term "incurred".

In Hong Kong, the leading case sounding to the interpretation of s.16, and in particular the meaning of "all outgoings and expenses to the extent to which they are incurred ... in the production of [chargeable] profits" is the case of ***Lo & Lo v. CIR*** [1984] 2 HKTC 34, in which the student has the very considerable advantage of the judgments of Hunter J.. the Court of Appeal and the Privy Council. The clear differences in the facts of ***Lo & Lo*** from those of the present case do not, I think, permit departure from the principle espoused in the speech of Lord Brightman who noted (at p. 73) that

> "... an expense incurred is not confined to a disbursement, and must *at least include a sum which there is an obligation to pay, that is to say, an accrued liability which is undischarged.*" (emphasis added)

Further, in ***CIR v. Mitsubishi Motors New Zealand Ltd.***, *op. cit.*, Lord Hoffmann, after reviewing leading Australian and New Zealand cases in this area, observed as follows (at p. 327E-G):

> "As has been said, their Lordships agree with the Court of Appeal that the language in which the warranty was expressed made liability dependent upon the manifestation and notification of the defect within the 12 month period. But the Australian authorities show that the question of whether the taxpayer is "definitively committed" to an expenditure or whether it is merely "impending, threatened or expected" (to adopt the language used in the leading case of Federal Commissioner of

> Taxation v. James Flood Pty. Ltd. (1953) 88 C.L.R. 492, 506-507) does not depend simply upon whether future events which may determine liability are expressed in the language of contingency or defeasance. Their Lordships think it would be strange if a concept so eminently practical as the computation of profits for income tax depended upon theoretical distinctions more appropriate to the rule against perpetuities. *The question is rather whether, in the light of all the surrounding circumstances, a legal obligation to make a payment in the future can be said to have accrued.* For this purpose, merely theoretical contingencies can be disregarded." (emphasis added)

Has such a legal obligation accrued in the present case? This question involves a consideration of the key provisions of the relevant Agreements.

Section 3 of the Subordinated Loan Agreement reads as follows:

> "3. The Borrower and the Subordinated Lender acknowledge to and agree with each other that so long as any monies remain outstanding from the Borrower to the Principal Lenders by virtue of the Loan Agreement, the Indebtedness shall be subject to the following terms and conditions: -
>
> (a) the Indebtedness shall not be subject to payment of interest (although interest may accrue thereon);
>
> (b) the Subordinated Lender shall not be entitled to receive on account of the Indebtedness prior to the date of final payment in full to the Principal Lenders of all monies due to the Principal Lenders by the Borrower under the Loan Agreement any amounts whether upon the winding up or dissolution of the borrower or for any other reason whatsoever; ..."

Corresponding provisions in the **Shareholders Subordination Agreement** are also in the following terms: -

> "2. SUBORDINATION
>
> (A) Subordination of Subordinated Indebtedness:
>
> .....

(2) Each of the Parent Companies agrees that it shall have no entitlement to receive any amounts which it would but for the provisions of this Agreement have been entitled to receive on account of the Subordinated Indebtedness prior to the Termination Date, whether upon the winding up or dissolution of the Borrower or either Owning Company or otherwise.

(B) Payment of Subordinated Indebtedness:

Each of the Parent Companies, the Borrower and the Owning Companies hereby undertakes that, notwithstanding anything to the contrary contained in any agreement or other document constituting or evidencing the Subordinated Indebtedness whether now in existence or hereafter entered into, the terms of all Subordinated Indebtedness shall be varied or deemed to be varied so as to provide that no amount shall be payable to either Parent Company on account of the Subordinated Indebtedness prior to the Termination Date."

What these provisions do *not* amount to, says Miss Chung, is an accrued liability in the sense used by Lord Brightman. She argues that there is here no vested right, no present right to demand payment, and, as a corollary, no obligation to pay and thus no liability. To the contrary, says Mr. Kotewall Q.C. whilst there is no *actual* outgoing, there is a demonstrable *incurring* of that outgoing (or, perhaps more precisely, the obligation underpinning that outgoing), and in this regard he drew my attention to several Australian authorities, including the useful summary contained in the judgment of Henry J. in ***A.M. Bisley & Co. Ltd. v. CIR*** [1985] 7 N.Z.T.C. 5,082 at 5,096:

"First, a particular expenditure is 'incurred' for tax purposes in an income year if it constitutes an existing obligation which arose in the course of that year. Second, where the expenditure arises under a written deed or agreement, whether or not it constitutes an existing obligation is a question of construction of that deed or agreement. Third, that the expenditure is not payable until some future date does not of itself destroy its nature as an existing obligation. Fourth, that the expenditure is a defeasible liability does not of itself destroy its nature as an existing obligation."

Also referred to in this context where the observations of Fuad V.-P. in ***CIR v. County Shipping Co. Ltd.*** [1990] 3 HKTC 267 at p. 287, who said:

> "... [in]sofar as interest is concerned, it seems to me that if the opening words of s.16(1) which occur before the word "including" are satisfied, *the outgoing will have been incurred whether it has actually been paid or not.*" (emphasis added)

Looked at in the round, says Mr. Kotewall Q.C., in this particular fact situation is there a definite obligation or liability to pay a sum, albeit in the future? If so, liability has been attracted, and this is clearly the situation in this case.

I agree with his analysis. The borrowing of money, and the ongoing accrual of interest at the stated rate, has taken place. Whilst repayment has been deferred, the incurring of liability has not been so deferred. The fact, as Miss Chung also argued, that upon final payment of the Superior Indebtedness there may be a requirement to enter into some form of additional agreement with regard to the actual payment of interest seems to me to be no more than a matter of mechanics, and not to impugn the fundamental principle, nor do I attach any significant weight to the theoretical possibility that such payment ultimately may not, for some reason, be made; accordingly I do not accept that, as Miss Chung put it, the figure in the accounts representing the interest deduction is "hedged around ... with every kind of contingency or speculation": see ***Owen v. Southern Railway of Peru, Ltd.*** 36 T.C. 602 at p. 642.

At the end of the day, therefore, I am against Miss Chung on this point, although I confess that I was initially attracted to her argument in terms of the absence of a *present right* to demand payment: I note here the reservation contained in the dictum of Lord Brightman in ***Lo & Lo***, *op. cit.*, at p. 73: -

> "Their Lordships should not be taken as necessarily agreeing with the implication in the judgment of Mr. Justice Hunter that, if the firm are entitled to make a deduction in respect of the retirement sums earned by long service employees, they are equally entitled to make an appropriate deduction in respect of employees who are in process of qualifying as long service employees but have not yet done so. Such employees do not have any present right to demand payment, and different considerations may apply in their cases."

That observation, however, was made *obiter* in the context of the particular facts of that case, as to which there is, I think, a clear distinction - in the instant case the interest obligation is running from Day One, so to speak, so that there is an accrual of "a legal obligation to make payment in the future."

Accordingly, my answer to the first question posed is in the negative, and I am in agreement with the finding of the Board (at para. 8.6.1.1 of the Stated Case) in this regard.

(2) ***Whether the Board has erred in law in finding that the interest in question was payable within Section 16(1)(a) of the Inland Revenue Ordinance.***

The argument under this head is not as to the intrinsic meaning of the word "payable", but whether that term in the statute is to be read, in effect, as "payable during the basis period."

Miss Chung suggests that it should. She argues that since the ordinary and natural meaning of the word "payable" is "presently due or owing", reference to payable must connote payable *during* the basis period, an interpretation she says which is consistent with the interest tax regime as it then existed within Part V of the Ordinance, and in particular the provisions of s.28. She further argued that s.16(1)(a) must be read in the context of the other subsections of s.16(1) which use the word "paid" (which must, in these other contexts, mean "paid in the basis period"), and the fact that "incurred" in the carriage to s.16(1) is expressly so qualified.

She also derives comfort from the use of the term "including" in the carriage to s.16(1), and suggests that s.16(1)(a) must be read in the context of s.16(1) and not in a manner contradictory to it. She also submits, perhaps surprisingly given that Mr. Kotewall Q.C. relies upon the same passage, that in this regard the judgment of Hunter J. in ***Lo & Lo***, op. cit. (at p. 55) is in her favour, and that Lord Brightman's observations in ***Lo & Lo***, op. cit. at 71-72, namely that:

> "It is correct to regard a retirement benefit as a sum payable in future, because there is no liability to pay until a future date arrives, namely the date when the employee leaves the firm's employment ..."

are made in a particular (and quite distinguishable) factual context.

In this connection Miss Chung also prays in aid the particular terms of the Agreements, and points out that in Clause 2(B) of the Shareholders' Subordination Agreement it is specifically provided that "no amount shall be payable" to the Parent Company on account of the Subordinated Indebtedness prior to the Termination Date.

Mr. Kotewall Q.C. disagrees with Miss Chung's submission. He says that the word "payable" in s.16(1) carries with it no necessary quality or requirement as to time; "payable" simply means a liability to pay, and is consistent with the use of the word "incurred" in the carriage of s.16(1). In this context he relies upon the example given by Hunter J. in ***Lo & Lo***, op. cit. (at p. 55):

> "There are, I think, two subsidiary considerations which point to the same conclusion. First in relation to the permitted deductions in section 16(1)(*a*) the word used is "payable" not "paid". Does this word require that the item be payable *in* the material year as the Commissioner argues on the definition in **Nilsen**; or in that year *or* the future as the appellants urge on the reasoning in **Owen**. The matter was tested in argument against the exception "legal fees". Take this example. A trading taxpayer instructs a solicitor in relation to litigation directly relevant to his trading receipts. This litigation extends over three accounting periods. No bill is rendered and/or taxed until after the litigation is concluded. Until that event, says the Commissioner, all contingencies have not been removed and no quantified sum is clearly due and payable. This premise may well be correct. From this the Commissioner concludes that the whole sum is a permissible deduction only in the third year. I cannot agree that this distortion of the true position is made necessary by the word "payable". It seems to me simpler, more straightforward, and consistent with the use of this word, to say in year 1 that something must be payable to the solicitors and to deduct an estimated sum or provision in that year. The **Owen** reasoning is equally applicable and convincing."

Mr. Kotewall Q.C. further argues that the reason for the absence of any temporal restriction on the word "payable" is clear, namely, once it be accepted that a liability can be incurred to pay in the future, any restriction as to time in relation to the word "payable" would be unworkable because the incurring and payment of the expense in deferred payment cases may well take place in different basis periods. And that if the Commissioner's argument be correct as to sums being payable during the same basis period, the incurring of such an immediate liability would not be deductible because in the period of its "incurring" the sum may well not be "payable" in that period, whilst in the further period when such payment was in fact made, there is no identity with the "incurring" which occurred during an earlier period. In short, he said, to accept the Commissioner's contentions in this regard would be to produce an inconsistency with the concept of "incurring" in s.16(1). This, he further says, is not only clear as a matter of construction, but also departs from the fundamental reasoning in ***Lo & Lo***, *op. cit.*

At the end of the day, it seems to me that if the legislature had intended to limit "payable" in the manner in which the Commissioner now suggests, it would have said so; in a tax statute what you see is what you get, and I am here reminded of the judgment of Leonard V.-P. in ***Lo & Lo***, quoting with approval the following dictum ***Cape Brandy Syndicate v. IRC*** [1921] 1 K.B. 64 (at 71):

> "... one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied."

I note also in this connection that the intent and purpose of s.16(1)(a), as interpreted in ***County Shipping***, op. cit., is to limit the deductibility of interest expenses to those cases where one of the conditions in s.16(2) is satisfied; thus the word "payable", when used in s.16(1)(a) in the context "sums payable by way of interest" must be intended to delineate the nature of the "sum", but not to lay down any temporal restriction. It further seems unlikely, given the use of this particular word, that it was intended to deprive a taxpayer of the right to deduct an interest expense when that expense was used to earn assessable profits on the basis simply that actual payment was deferred to a subsequent period. Interest incurred for a particular period represents a liability to compensate the lender for being kept out of his money for that period, and were the liability not to be attributed to that period, but to the period in which the same was actually paid or discharged, there would be clear scope for distortion of the actual profit or loss of the taxpayer in the relevant years.

Mr. Kotewall Q.C. supported his analysis by reference to a number of Australian authorities where it has clearly been accepted that if the taxpayer has completely subjected himself to a liability, albeit not paid but payable in the future, liability has been incurred, and that this is so even if the figure cannot at the time be precisely calculated. See, for example, the dictum of Hill J. in ***Ogilvy & Mather*** [1990] 21 ATR 841 (at 873 to 874):

> "An outgoing may be incurred notwithstanding that at the end of the year of income it represents a present liability then due although *payable in the future* ... A reasonable estimate of an outgoing *payable in the future* where the amount of that outgoing cannot be ascertained with precision at the end of the year of income will be incurred where it represents a pecuniary liability encountered in the year of income but provided it is capable of reasonable estimation." (emphasis added)

In this connection my attention was drawn also to dicta in ***Federal Commissioner of Taxation v. James Flood Pty. Ltd.***, [1953] 88 CLR 492 (at 506), and in ***Commonwealth Aluminium Corporation Ltd.***, [1978] 32 FLR 210 (at 232).

Accordingly, after reflecting on the respective submissions which have been made on the point, I conclude that the Board was correct in its finding that the interest was payable within s.16(1)(a), and accordingly that question (2) should also be answered in the negative.

In my view, the next two questions can conveniently be taken together, and I reproduce them below.

(3) ***Whether the Board has erred in law in finding that at the material times the interest in question was chargeable to tax under the Ordinance by operation of the then Section 28(1).***

(4) ***Whether the Board has erred in law in finding that insofar as the interest in question was concerned, the condition set out in Section 16(2)(c) of the Ordinance has been satisfied.***

The finding of the Board in this context was that, as regards s.16(2)(c), at the material times the sums payable by way of interest were chargeable to tax under the Ordinance by operation of the then s.28(1) and, accordingly, deductible.

In his submissions, Mr. Kotewall Q.C. emphasised the primary distinction in the phrase "chargeable to tax" when used in s.16(1) and s.16(2)(c) respectively. In s.16(1) the phrase refers to the chargeability to tax of the *payer* of the interest expense in relation to the profits for the production of which the interest was incurred; whereas chargeability to tax in s.16(2)(c) refers to chargeability to tax of the *payee* of the interest *receipt* in relation to that receipt. And it is of course the taxpayer's case that the interest in question, when incurred in the relevant taxation period, was clearly chargeable to tax for the purpose of s.16(2)(c) under the *then existing* and applicable s.28(1), the relevant provisions of which I set out below:

> "**28.** (1) Interest tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on the recipient of any sum paid or credited to him in that year being -
>
> (*a*) interest arising in or derived from Hong Kong on any debenture, mortgage, bill of sale, deposit, loan, advance or other indebtedness whether evidenced in writing or not; ..."

In ***CIR v. Mutual Investment Co. Ltd.*** [1987] 1 A.C. 587, it was held that an item of expenditure was deductible if it is referable to the production of profit "in respect of which a taxpayer may be at some time chargeable to tax under Part IV" of the Ordinance (per Sir Garfield Barwick at p. 601). In that case the Privy Council clearly considered expenses to be deductible if incurred to produce profits, though not charged or chargeable in the same basis period but only chargeable when earned or accrued in future. *A fortiori*, said Mr. Kotewall Q.C., interest incurred must be chargeable for the purpose of s.16(2)(c) if it is chargeable *when paid or credited* in future.

In the premises, Mr. Kotewall argued, it is clear that chargeability refers to the nature and quality of the sum involved as something which may potentially be charged, and not to whether it has *in fact* been charged. And there can be no doubt that but for the amending Ordinance, whereby s.28(1) was repealed by the Inland Revenue (No. 2) Ordinance, 1989, the interest would have been chargeable to tax in the hands of the Parent Company when the same was paid or credited to it in the year of assessment subsequent to the year in which the interest expense accrued. Moreover, the use of the word "chargeable" as opposed to "charged" indicated clearly that the legislature intended that the interest expense was to be deducted when it was incurred or when it accrued, and not when it was actually paid, if that was in a latter taxation period. Thus, when interest was accruing on a daily basis in the relevant taxation period, such interest was a sum "payable by way of interest chargeable to tax" within the terms of s.16(2)(c), being chargeable for some year of assessment in the future. *Ergo*, said Mr. Kotewall Q.C., all the conditions for deductibility were satisfied at the material times and the taxpayer had an accrued right to deduct the same in the computation of its tax liability.

Miss Chung submitted that the taxpayer's argument in this regard was plainly wrong as a matter of law. She submitted that chargeability to interest tax depended upon the *actual payment* or credit of such interest, and that any question of the accrual of such interest to the Parent was irrelevant. Whilst Miss Chung specifically accepted, on behalf of the Commissioner, that the term "chargeability" as referred to in s.16(2)(c) included chargeability in *future years* of assessment, nevertheless she maintained that the taxpayer's case involved an artificial and hypothetical approach which was clearly incorrect. She argued that the Respondent's approach appeared to suggest that chargeability was a question to be determined at the date of the transaction, that is, that so long as the Parent Company was within s.16(2)(c) and s.28 of the Ordinance when the transaction was entered into in February 1987, there would be compliance with the provisions of s.16(2)(c). That could not be right, she said. The power to make assessments under s.59 of the Ordinance arises only after the issue of the relevant return for the tax year in question, section 59 specifically providing that:

> "**59. Assessor to make assessments**
>
> (1) Every person who is in the opinion of an assessor chargeable with tax under this Ordinance shall be assessed by him as soon as may be after the expiration of the time limited by the notice requiring him to furnish a return under section 51(1): ..."

And as profits tax returns are issued in the year following the year of assessment, the assessor's power under s.59 could only be invoked after the relevant year of assessment by applying the statutory provisions *then* prevailing. To adopt the

Respondent's approach, said Miss Chung, would mean that an assessor had to raise a notional assessment on the date of the transaction, and the question of assessibility or deductibility could only be determined by checking the relevant provisions at the dates of the various different transactions entered into by the company. The fallacy of the Respondent's argument, she said, was evidenced by the fact that for the year of assessment 1989/90 and subsequent years, the interest expenses would be deductible even if the interest incurred would statutorily not be *chargeable* to tax, by reason of the repeal of the relevant provisions.

It followed therefore, said Miss Chung, that on the facts of this particular case, the question of chargeability had to be determined by the relevant tax provisions in existence at the date of the relevant assessments; in other words, chargeability must be determined *at the time of the assessment* in light of the statutory provisions then prevailing. There was no suggestion in this case that the assessments in question were not issued in the normal course of events, and given that interest tax was abolished from 1st April 1989, it followed that *prior to* 1st April 1989, the interest concerned was never paid nor credited, and therefore was not chargeable to interest tax; and that, *with effect from* 1st April 1989, interest tax had been abolished, so that no question of chargeability to interest tax arose.

I confess to having had some difficulty with this argument. It seems to me axiomatic that the deductibility of an expense must be governed by the provisions and conditions existing at the time, and not with the benefit of hindsight. Were this not to be so, expenses incurred in a taxation period to produce chargeable profits in the future may not be deductible, which, in effect, would render nugatory the effect of the words "for any period" in s.16(1). Moreover, the effect of the Commissioner's argument would be to require the taxpayer (and also the Commissioner) to speculate, in the relevant taxation period in which the interest expense was incurred, as to what might happen to the statutory provisions governing the chargeability to tax of such interest.

With respect, it seems to me that this cannot be correct. The deductibility of interest must be governed by the *then existing* provisions, including s.28(1), which clearly provided that the interest when paid would be chargeable to tax in the relevant year of assessment. Otherwise, as Mr. Kotewall Q.C. pointed out, the position would be that the interest expense would not be deductible in the year of its incurring because, on the reasoning of the Commissioner, chargeability is uncertain, and there may be doubt as to whether the interest expense is deductible in the basis period of payment (on the assumption of s.28(1) has not been repealed), because the expenses may not be "incurred" in that basis period, with the consequence that s.16(1) could not be satisfied. The result of this would be that the interest expense may never be deductible, a consequence which is contrary to the structure and wording of both s.16 and also of s.28 (as it then stood), and further contrary to the principle in ***Mutual Investment***, *op. cit.*

Accordingly, when looked at in the round, I find it difficult to accept Miss Chung's primary proposition that chargeability refers, in effect, to potential chargeability, which can only be determined at a later date after having regard to what might have arisen in terms of legislative amendment or repeal. This is a bold proposition, but not, I think, one which withstands analysis. At the end of her submissions in reply, Miss Chung further observed that the point made as to the intrinsic arbitrariness of the date of assessment was itself matched by the arbitrariness of the date of the Agreements in question in this case. This may be so in one sense, but it seems to me that the crucial distinction is that whereas the date of the assessor's assessment pursuant to s.59 is truly an arbitrary date, the date of the Agreements, whilst obviously historical, cannot be arbitrary in its effect, in that this is precisely the date which provides the factual underpinning from which consequent rights and obligations flow. Perhaps I may be permitted the comment at this stage that I hope that I have understood correctly the Commissioner's arguments under this head, not least because the proposition advanced with such assurance seems at variance with normally accepted canons of construction.

At the end of the day, therefore, if and insofar as the repeal of s.28(1), together with the rest of Part V of the Ordinance, serves to provide the taxpayer with what Mr. Kotewall Q.C. chooses to term "a windfall", so be it. The existence of such a "windfall", if indeed such it be, is not, in my view, a good reason to strain the construction of the statutory provisions in order to prevent such an effect occurring. Accordingly, I find myself in the position of also rejecting the Commissioner's arguments in this regard, and in agreement with the conclusion of the Board of Review. My answer to questions (3) and (4), therefore, is also in the negative.

(5) ***Whether the Board has erred in law in finding that the interest in question was deductible in the computation of assessable profits of the Appellant in the relevant years.***

I consider, I hope correctly, that this question is essentially of a "sweeping-up" nature, and is one which has been answered by necessary implication in terms of the responses to the previous questions. It follows, therefore, that for the reasons that I have stated, in my judgment the conditions for the deductibility of the interest in question have been satisfied. Accordingly, this question is also answered in the negative, and in favour of the taxpayer.

THE RESULT OF THIS APPEAL

It follows from my responses to the questions posed that in my judgment the decision of the Board was correct, and that this appeal must be dismissed. I make an order nisi that the costs of and occasioned by the appeal be to the Respondent.

One further matter arises. It is essentially an housekeeping issue. In her able concluding comments Miss Chung pointed out that in relation to the 1987/88 and 1988/89 assessments, there had been no formal determination by the Board, and that accordingly it would be necessary to remit the case back to the Board, pursuant to the provisions of s.69(5), for there to be a formal determination of the 1987/88 and 1988/89 assessments in light of the opinion of the Court upon the five stated questions. It may be that this is technically correct, although, with respect, it seems to me to be unnecessary. Both counsel agree that this was a clear oversight on the part of the Board, and it would seem not unreasonable that the case could now be dealt with on the basis of this judgment, notwithstanding this technical difficulty. This is particularly so in light of the sad fact that the Board can no longer be constituted with the like membership as that which heard the taxpayer's appeal, and which was responsible for remitting the formal Case Stated. Accordingly, if and insofar as the Commissioner, upon receipt of this judgment, wishes to make further submissions upon the correct course to adopt, I will of course entertain any such submissions; in the meantime, however, the matter will rest with the order made herein, and no doubt the parties will arrange the formal engrossment of that Order.

Finally, I wish to express my thanks to both counsel for the clarity and care with which they presented their arguments. I am much indebted.

(William Stone)
Judge of the High Court

Miss Ada Chung, Assistant Principal Crown Counsel of Attorney-General, for the Appellant.

Mr. Robert Kotewall Q.C. and Mr. Stewart K.M. Wong, instructed by Messrs. Mallesons Stephen Jaques, for the Respondent.