HCIA 1/98

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
INLAND REVENUE APPEAL NO.1 OF 1998

BETWEEN

COMMISSIONER OF INLAND REVENUE — Appellant

and

YICK FUNG ESTATES LIMITED — Respondent

AND

HCIA 2/98

INLAND REVENUE APPEAL NO.2 OF 1998

BETWEEN

YICK FUNG ESTATES LIMITED — Appellant

and

COMMISSIONER OF INLAND REVENUE — Respondent

(CONSOLIDATED)

Coram : The Hon Mrs Justice Le Pichon in Court
Dates of Hearing : 19, 20 and 21 October 1998
Date of Judgment : 30 October 1998

J U D G M E N T

This appeal arises out of Inland Revenue Appeal Nos. 1 and 2 of 1998 which have been consolidated by order by consent dated 24 August 1998.

The facts

Yick Fung Estates Limited ("the Taxpayer") commenced business prior to 1 April 1974. For the purposes of Part IV of the *Ordinance*, it is an old trader. It had an accounting date of 30 June. In the year of assessment 1988/89, it changed its accounting date to 31 March.

The Taxpayer's profits for its accounting periods relevant to this appeal are as follows :

Accounting Period	**Profits**
1.7.86 to 30.6.87	$146,038,904
1.7.87 to 30.6.88	$164,835,439
1.7.88 to 31.3.89	$108,327,586
1.4.89 to 31.3.90	$149,704,766

The Commissioner raised a Second Additional Profits Tax Assessment for the year 1988/89 in respect of the profits of $108,327,586 earned by the Taxpayer in the nine months from 1 July 1988 to 31 March 1989. The assessable profits for the year of assessment 1988/89 was thus computed by reference to the profits made in the period of 21 months from 1 July 1987 to 31 March 1989. In issue is the Commissioner's power to raise the Second Additional Profits Tax Assessment, the profits tax in question amounting to over $18 million.

The legal issues

Two questions of law arise on the case stated by the Board of Review ("the Board") for the opinion of this court pursuant to section 69 of the *Inland Revenue Ordinance*. They are—

1. whether, as a matter of law and as a matter of statutory construction, the Board is correct in holding that in the year of change of accounting date for a trader who commenced business before 1 April 1974 the Commissioner is not entitled to use a basis period of more than 12 months (the section 18E or construction point); and

2. whether, on the facts found by the Board, the Board was correct as a matter of law in holding that the Commissioner of Inland Revenue was entitled by virtue of section 61A of the *Inland Revenue Ordinance*,

Cap.112, to assess 21 months of profits in the year of assessment 1988/89 (the section 61A or tax avoidance point).

Section 18E : the construction point

The relevant statutory provision reads as follows :

" (1) Where the assessable profits of a person from any trade, profession or business carried on in Hong Kong have been computed by reference to an account made up to a certain day in any year of assessment and either—

(a) that person fails to make up an account to the corresponding day in the following year of assessment; or

(b) that person makes up accounts to more than one day in the following year of assessment,

then—

(i) the assessable profits from that source for the year of assessment in which the circumstances described in either paragraph (a) or (b) prevail shall be computed on such basis as the Commissioner thinks fit; and

(ii) the assessable profits for the year preceding that year of assessment shall be recomputed on such basis as the Commissioner thinks fit.

(2) For the purposes of subsection (1)—

(a) ...

(b) in the case of a trade, profession or business which was commenced on or after 1 April 1974, the Commissioner may, if he considers it necessary, make a computation under subsection (1) in respect of a basis period which exceeds 12 months."

Section 18E applies when a change of accounting date occurs during a year of assessment commencing after 1 April 1975. It is common ground that the events described in paras.(a) and (b) of subsection (1) of section 18E occurred during the year of assessment commencing on 1 April 1988 in relation to the Taxpayer so as to render the discretion contained in para.(i) of subsection (1) exercisable. The point of construction which arises is whether the Commissioner is entitled to use a basis period longer than 12 months in the year of change.

The Taxpayer submitted that there is a very clear inference from the terms of sub-para.(2)(b) that in the case of an old trader, i.e. someone who commenced trading prior to 1 April 1975, the Commissioner cannot make a computation in respect of a basis period which exceeds 12 months. If the discretion contained in subsection (1) of section 18E did permit the use of a basis period in excess of 12 months, then section 18E(2)(b) would be otiose. The Taxpayer submitted that if section 18E were put in its proper context, it becomes apparent why a distinction had to be drawn between old traders and new traders and why the discretion contained in section 18E(1) does not authorize the use of a basis period in excess of 12 months in the case of old traders.

The context requires a consideration of the old rules for charging profits tax which was on a preceding year basis. Section 18 ceased to have effect in relation to a year of assessment commencing on 1 April 1975. Under the old rules, the profits of the first year of trading were in effect assessed more than once. However, upon cessation, some of the profits of the trader in his final years of trading dropped out of the charge to tax.

The following example illustrates the operation of the old rules, ignoring changes to the law made in 1975. The example assumes profits of $10,000 per annum from 1/7/71 to 30/6/73 and profits of $12,000 per annum from 1/7/73 onwards.

<u>EXAMPLE 1</u>

COMMENCEMENT DATE : 1/7/71
CESSATION DATE : 31/3/94
ACCOUNTING DATE : 30th JUNE

YEAR OF ASSESS-<u>MENT</u>	RELEVANT <u>SECTION</u>		<u>PROFIT ASSESSED</u>	<u>REMARKS</u>
			$	
1971/72	S18(3)	1/7/71-31/3/72	7,500	
1972/73	S18(4)	1/7/71-30/6/72	10,000	OVERLAP:9 MONTHS
1973/74	S18(2)	1/7/71-30/6/72	10,000	OVERLAP:12 MONTHS
1974/75	S18(2)	Y.E.30/6/73	10,000	
1975/76	S18(2)	Y.E.30/6/74	12,000	

....

1992/93	S18(2)	Y.E.30/6/91	12,000	
		Y.E.30/6/92	12,000 NOT ASSESSABLE	)GAP:21 MONTHS
		1/7/92-31/3/93	9,000 NOT ASSESSABLE	)
1993/94	S18(5)	1/4/93-31/3/94	12,000	

NO. OF MONTHS IN OPERATION (1/7/71 TO 31/3/94)		273
NO. OF MONTHS ASSESSED		273
TOTAL PROFIT MADE	$269,000	
TOTAL PROFIT ASSESSED	$265,500	

It is apparent from Example 1 that the overlap in the initial years aggregating 21 months was compensated for upon cessation in that the profits for the period from 1/7/91 to 31/3/93 dropped out of the charge to tax.

The preceding year basis of taxation was replaced by the current year basis commencing with the year of assessment 1974/75. For an old trader, the year of assessment 1974/75 was the transitional year. Section 18A applied. The effect was that the lower of the profits of the basis periods ending in 1973/74 and 1974/75 which were taxable for the year of assessment 1974/75 fell out of the charge to tax. On the subsequent cessation of business by an old trader, tax in the final year of assessment was limited to the amount of profits from 1 April in the final year of assessment with the consequence that for an old trader with a non-March year end, the profits from the end of the previous basis period up to 31 March fell out of account ("the cessation drop-out").

Because this 'drop-out' was open to manipulation, section 18D(2A) was added in 1980. Although subsection (2A) is a complex and difficult provision, the parties accept that its effect is succinctly and accurately stated in *Flux on Hong Kong Taxation* 1998/99 Edn. at page 274 :

> " The effect of the law as it now stands ... is that the basis period for the year of assessment in which the cessation takes place is the period from the end of the basis period for the previous year of assessment up to the date of cessation (i.e. the same as for a business which commenced after 1st April 1974) less a 'transitional amount'. The 'transitional amount' is the broad equivalent of the drop-out which would have occurred under the old rules, but is based on a proportion of the assessable profits for the 1974/75 year of assessment and is, therefore, already fixed in respect of cessations which have not yet taken place although ..., even this is the maximum amount because there are

limitations to the transitional amount depending upon what profits arise in the cessation period."

Example 2 below illustrates how the new provisions operate in relation to the facts of Example 1.

EXAMPLE 2

YEAR OF ASSESS-MENT	RELEVANT SECTION	BASIC PERIOD	PROFIT ASSESSED	REMARKS
			$	
1971/72	S18(3)	1/7/71-31/3/72	7,500	
1972/73	S18(4)	1/7/71-30/6/72	10,000	OVERLAP:9 MONTHS
1973/74	S18(2)	1/7/71-30/6/72	10,000	OVERLAP:12 MONTHS
		Y.E.30/6/73	10,000 NOT ASSESSABLE	GAP: 12 MONTHS
1974/75	S18A(2)	Y.E.30/6/74	12,000	
1975/76	S18B(2)	Y.E.30/6/75	12,000	
1976/77	S18B(2)	Y.E.30/6/76	12,000	
…………				
1993/94	S18D(2A)	1/7/92-31/3/94	12,000 *	

NO. OF MONTHS IN OPERATION (1/7/71 TO 31/3/94)		273	
NO. OF MONTHS ASSESSED		273	
* PROFIT 1/4/93 – 31/3/94 S18D(2)		12,000	
1/7/92 – 31/3/93 S18D(2A)		9,000	

		21,000	
LESS PROFIT 1/7/74 – 31/3/75	S18D(2A)		
(TRANSITIONAL AMOUNT)		9,000	GAP : 9 MONTHS

		12,000	
		=====	

TOTAL PROFIT MADE $269,000
TOTAL PROFIT ASSESSED $267,500

The 'transitional amount' effectively drops out of the charge to tax but the amount is capped : it cannot exceed the amount that would have dropped out if the law had not changed. Examples 1 and 2, it is said, demonstrate that the focus of the old rules was to levy tax by reference to the number of months in the life of the business rather than actual profits derived therefrom which is the focus of the new rules.

The Commissioner accepts that Examples 1 and 2 set out above illustrate how the old rules and the new rules operate in the case of an old trader upon cessation. It is also common ground that during the transitional year, an old trader had the benefit of a one year drop-out and that for a trader with a non-March year end, there was a further drop-out period (i.e. the cessation drop-out) which is broadly equivalent to the drop-out which would have occurred under the old rules save that the amount cannot exceed a proportion of the assessable profits for the 1974/75 year of assessment. The Commissioner also accepts that *if* there is no change, the months assessed would coincide with the duration of the business. He does not accept that if the accounting date is changed, there must be the same drop-out period.

Example 3 below is based on the same assumptions as the earlier examples save that there is a change of accounting date in 1988/89 from 30/6/88 to 31/3/89 and highlights what is in dispute.

EXAMPLE 3

CHANGE OF ACCOUNTING DATE : 31/3/89

YEAR OF ASSESS-MENT	RELEVANT SECTION		PROFIT ASSESSED	REMARKS
			$	
1971/72	S18(3)	1/7/71-31/3/72	7,500	
1972/73	S18(4)	1/7/71-30/6/72	10,000	OVERLAP:9 MONTHS
1973/74	S18(2)	1/7/71-30/6/72	10,000	OVERLAP:12 MONTHS
		Y.E.30/6/73	10,000 NOT ASSESSABLE	GAP:12 MONTHS
1974/75	S18A(2)	Y.E.30/6/74	12,000	
1975/76	S18B(2)	Y.E.30/6/75	12,000	
1976/77	S18B(2)	Y.E.30/6/76	12,000	
....				
1988/89	S18B(2)	Y.E.30/6/88	12,000	
		1/7/88-31/3/89	9,000 **ASSESSABILITY DISPUTED**	
1989/90	S18B(1)	Y.E.31/3/90	12,000	
....				

NO. OF MONTHS IN OPERATION (1/7/71 TO 31/3/94) 273
TOTAL PROFIT MADE $269,000

On the Taxpayer's analysis, the number of months assessable to tax matches the number of months of trading and the amount assessable to tax would be $267,500. On the Commissioner's analysis, the number of months assessable to tax would exceed the life of the business by nine months and the amount assessable to tax would be $278,000.

In relation to the proposition that an old trader is not to be taxed on the basis of a number of months that exceeds the number of months over the life of the business, it is to be noted that none of the provisions in the *Ordinance* expressly so provides. Although in Examples 1 and 2 above, the number of months assessable to tax happens to match the number of months in the life of the business, it is not a sufficient reason for extrapolating from that coincidence that it must hold true even where there has been a change in accounting date. To draw such an inference simply begs the question.

The thrust of the Taxpayer's contention is that by changing its accounting date from 30 June to 31 March, it was doing no more than accelerating the 'cessation drop-out', to which it is 'entitled' (the 'acceleration' argument). If there is any perceived loss of revenue or manipulation through the acceleration of the cessation drop-out, that can only be addressed by way of a legislative amendment to section 18E, by adding to it a provision corresponding to section 18D(2A). It is also the Taxpayer's case that having regard to the context, the discretion contained in section 18E(1) cannot be exercised in respect of a basis period that exceeds 12 months save and except where section 18E(2) applies. Implicit in and underpinning this submission is the contention that the discretion contained in the old section 18(2) which was triggered by a change in accounting date did not permit the use of a basis period in excess of 12 months. I will deal with these arguments in turn.

The acceleration argument

Under the old rules as well as the new rules, certain periods (which are not identical) simply fell out of charge to tax. The cessation drop-out is therefore the net effect of the operation of the cessation provisions. Whilst in a sense the Taxpayer may be said to be 'entitled' to the cessation drop-out, whether under the old or the new rules, the cessation provisions do not in terms expressly confer on the Taxpayer any such right or entitlement. More importantly, there is nothing in section 18E, or for that matter in any of the other provisions introduced since 1975, which confers on the Taxpayer a right to 'elect' *when* to take the cessation drop-out. To be 'entitled' to a drop-out on cessation is one thing. To equate this with having a right to elect when to take this cessation drop-out involves making a quantum leap which the provisions of Part IV do not warrant.

It is not the Taxpayer's case that a trader is entitled to more than one cessation drop-out over the life of the business. Yet if the acceleration argument is correct, it could result in there being more than one cessation drop-out. As the Taxpayer accepts, there is no impediment to a trader changing his accounting date more than once. If the trader in

Example 3 having changed his accounting date to 31 March were to change his accounting date yet again (which then must mean a date other than a March date), a further cessation drop-out will necessarily arise upon actual cessation and that is a result that, on any view, is not contemplated by or provided for under Part IV of the *Ordinance*.

For these reasons, the acceleration argument appears to be misconceived and must be rejected.

The discretion under the old section 18(2)

The relevant part of section 18(2) provides :

> "...Where, however, the assessable profits from any trade, profession or business have been computed by reference to an account made up to a certain day, and no account is made up to the corresponding day in the year following, the assessable profits from that source both for the year of assessment in which such failure occurs and for the 2 years of assessment following shall be computed on such basis as the Commissioner in his discretion thinks fit."

Leading counsel for the Taxpayer submitted that the discretion was limited to "substituting a 12 months basis period". Section 18(2) did not permit a basis period in excess of 12 months because the profits that fell to be computed were profits for "years of assessment", i.e. periods of 12 months as defined in section 2(1). Although the old section 18(2) is spent, section 18E(1) which replaced it is subject to a similar restraint.

Mr Flesch Q.C. referred to the Commissioner's own Explanatory Notes made at the time the 1975 amendments were introduced. Whilst the Notes contain the usual disclaimer that the Notes and the Examples have no legal force and that the Commissioner will not be bound by the contents of the Notes, there is nothing in them that suggest that section 18E authorizes the Commissioner to adopt a basis period of more than 12 months in the case of old traders. Reference was made to paragraph 17 of the Notes and in particular to Examples 18 and 19 at pages 1886-7. In Example 18, where an old trader changed his accounting date from 30/6/78 to 31/12/78, the Commissioner never sought to suggest that the discretion in subsection (1)(i) of section 18E enabled it to adopt a basis period of 18 months. Rather, for the year of assessment 1978/79, the Commissioner used a basis period of one year from 1/1/78 to 31/12/78 and recomputed the assessable profits for the preceding year, i.e. 1977/78 by using a basis period of 12 months from 1/1/77 to 31/12/77 pursuant to its powers in section 18E(1)(i) and (ii).

The Taxpayer also relied on the decision of the Board of Review in Case D71/90 : Inland Revenue Board of Review Decisions Vol. 5 p.493 in support of its construction of section 18E. It would appear that in that case, the Commissioner contended that "for a business which commenced prior to 1 April 1974 the Commissioner may not make a computation under subsection (1) in respect of a basis period which exceeds 12 months", a contention which was upheld by the Board of Review (at 498).

The Commissioner's position is that the discretion in section 18(2) was unlimited : there was nothing to restrict the exercise of that discretion to a period not in excess of 12 months. The relevant discretion was to compute the "assessable profits" for the relevant years "on such basis as the Commissioner in his discretion thinks fit". The Taxpayer argued that as the profits that fell to be computed were profits for "years of assessment" i.e. periods of 12 months, that necessarily capped the period in respect of which the discretion could be exercised.

But what fell to be computed were "assessable profits" which 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." "Basis period" for any year of assessment is the period on the income or the profits of which tax for that year ultimately falls to be computed : section 2(1) of the *Ordinance*. There is nothing in that definition that restricts or limits the 'period' to a period that is not in excess of 12 months. The fact that a "year of assessment" means a period of 12 months is not determinative of the length of a "basis period".

As regards the Explanatory Notes, whilst accepting that they do imply that a period longer than a year would not be used for an old business which postponed its accounting date, the Commissioner invited attention to the fact that the Notes contain no positive statement to the effect that a period in excess of 12 months would never be used. In any event, it is common ground that the Notes are not binding whether on the Commissioner or on this court.

So far as reliance is placed on D71/90, Mr Herbert Q.C. submitted that the passage relied on was not necessary to the decision. The issue before the Board was whether it was open to the Commissioner to adopt a basis period of 12 months where the accounting date was brought forward (from February 1987 to September 1986) as in that case, even though this resulted in an 'overlap' of five months by bringing into charge five months of profits that had already been assessed for the year ended 28 February 1986 and hence the double use of profits. The taxpayer had proposed that a seven month period be used which would have had the effect of achieving a five month tax deferral. The Commissioner adopted a 12 month period. What is clear is that the power of the Commissioner to adopt a basis period in excess of 12 months was simply not an issue in that case. It is therefore not readily apparent why the submission which the Board upheld was made in the first place. Accordingly, I agree that the Board's decision in D71/90 is of limited assistance and, in any event, is not binding on this court.

In my judgment, having regard to the definitions of "assessable profits" and "basis period" and to the fact that what fell to be computed were "assessable profits", the Commissioner's contention is correct. The discretion in section 18(2) was unlimited : it was not confined to a 12 month period.

Conclusion

Neither the acceleration argument nor the context assists the Taxpayer's case. Rather, the context supports the Commissioner's construction of section 18E. If under the old rules, the discretion was unlimited, there would be no reason to cut down the discretion contained in section 18E(1) which was intended to replace the old section 18(2).

But if the discretion contained in section 18E(1) is similarly not confined to a basis period that is not in excess of 12 months, how is subsection (2)(b) to be explained?

Mr Herbert Q.C. contended that section 18E(2)(b) was included partly out of the abundance of caution in case it might be thought that under the new rules introduced in 1975, an up-to-date 12 month basis period was paramount for new businesses and partly to qualify that discretion in that the Commissioner must "consider it necessary" to use the longer period. In relation to new traders, the discretion (in section 18E(2)(b)) was not only more specific, it was limited. In other words, section 18E(2)(b) is not otiose if it were read as meaning *even* for new businesses, a longer period may be used.

On balance, the construction put forward on behalf of the Commissioner is to be preferred. The wording of the relevant part of section 18(2) and section 18E(1)(i) is virtually identical. The focus is again on "assessable profits". It is inconceivable that the discretion conferred by each of those provisions is different in terms of the length of the basis period that may be used. The construction put forward by the Commissioner gives a coherence to the old and new rules that is absent from that of the Taxpayer.

In my judgment, as a matter of law, the Board erred in holding that in the year of change of accounting date for a trader who commenced business before 1 April 1974, the Commissioner is not entitled to use a basis period of more than 12 months. Its holding must be reversed.

Section 61A : the tax avoidance point

The Taxpayer needs to succeed on both points if it is to succeed overall. In view of the conclusion I have reached on the construction of section 18E, it is not strictly necessary to consider the tax avoidance point. But in deference to the very full and able argument of counsel, and in case I am wrong on the construction point, the court's conclusions on the tax avoidance point are set out below.

Three separate and independent points were taken by the Taxpayer against the Board's decision on section 61A which provides as follows :

> " (1) This section shall apply where any transaction has been entered into or effected after the commencement of the Inland Revenue (Amendment) Ordinance 1986 (7 of 1986) (other than a transaction in pursuance of a legally enforceable obligation incurred prior to such commencement) and that transaction has, or would have had but for this section, the effect of conferring a tax benefit on a period (in this section referred to as 'the relevant period'), and, having regard to—
>
> (a) the manner in which the transaction was entered into or carried out;
>
> (b) the form and substance of the transaction;
>
> (c) the result in relation to the operation of this Ordinance that, but for this section, would have been achieved by the transaction;
>
> (d) any change in the financial position of the relevant person that has resulted, will result, or may reasonably be expected to result, from the transaction;
>
> (e) any change in the financial position of any period who has, or has had, any connection (whether of a business, family or other nature) with the relevant person, being a change that has resulted or may reasonably be expected to result from the transaction;
>
> (f) whether the transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm's length under a transaction of the kind in question; and
>
> (g) the participation in the transaction of a corporation resident or carrying on business outside Hong Kong,
>
> it would be concluded that the person, or one of the persons, who entered into or carried out the transaction, did so for the sole or dominant purpose of enabling the relevant person, either alone or in conjunction with other persons, to obtain a tax benefit.
>
> ....
>
> (3) In this section—
>
> ....

> 'transaction' (交易) includes a transaction, operation or scheme whether or not such transaction, operation or scheme is enforceable, or intended to be enforceable, by legal proceedings."

'Transaction'

The first point taken by the Taxpayer is that for the purposes of section 61A(3), 'transaction' does not embrace a single step of changing the accounting date. The Taxpayer submitted that (1) as what has been done is contemplated and authorized by the legislation, it is not a transaction; and (2) in any event, a 'transaction' must either involve (even passively) some other person or have an effect on some other person.

As regards (1) above, the submission was not further developed in argument. Suffice to say that it is not readily apparent why what is authorized by the legislation cannot amount to a 'transaction'. There is nothing to prevent it from being so.

As regards (2) above, at the outset, Mr Flesch Q.C. sought to refer to the statement of the Financial Secretary in the Legislative Council when section 61A was being considered. As it is not suggested that the present case falls within the rule in **Pepper v. Hart** [1993] AC 593, I do not see how that statement can be of assistance.

Reference was then made to several cases in which the meaning of the word 'transaction' was considered. **Grimwade v. Federal Commissioner of Taxation** (1949) 78 CLR 199 concerned value shifting through the exercise of voting rights. The High Court of Australia had to consider whether that fell within paragraph (f) of section 4 of the *Gift Duty Assessment Act*. Latham CJ and Webb J observed (at 220) that :

> "...But when a shareholder makes up his mind to vote in a particular way and casts his vote accordingly he cannot be said to be 'entering into a transaction.' A transaction by a person must be a transaction *with* some other person. In the circumstances mentioned there is no transaction with any person."

In **Regina v. Canavan and Busby** [1970] 3 Ontario Reports 353, Schroeder JA delivering the judgment of the court stated (at 356) that :

> " 'Transaction' is a word of quite comprehensive import, which, so far as I am aware, has never been the subject of any exact legal definition. The word has been interpreted as the justice of each case demanded rather than by any abstract definition. In its ordinary sense it is understood to mean the doing or performing of some matter of

> business between two or more persons...."

Finally in **Greenberg v. Commissioners of Inland Revenue** [1971] 47 LTC 240 Lord Reid, in considering the meaning of "transaction in securities", stated (at 271) that :

> "The word 'transaction' is normally used to denote some bilateral activity, but it can be used to denote an activity in which only a single person is engaged.... This definition shows that no bilateral element is necessary, for it includes applying or subscribing for new securities which are single acts done by one person only."

Nevertheless, the Taxpayer submitted that the examples there considered by Lord Reid of a "unilateral act" in fact involved more than one person whereas the mere change of an accounting date did not have that effect.

Mr Flesch Q.C. also referred to section 177A to G of Part IVA of the *Australian Income Tax Assessment Act* upon which, as is accepted, section 61A was modelled. Nevertheless there are differences between the two provisions : the key word in the Australian legislation is 'scheme' and not 'transaction'. Incidentally the word 'transaction' does not appear in the definition of 'scheme' in section 177A(1).

These citations are of limited assistance since the meaning of 'transaction' must depend on the context in which it appears and in each of those cases the context was different. In construing the meaning of 'transaction' for the purposes of section 61A, one needs to look at the definition contained in subsection (3). It is to be noted the 'transaction' *includes* 'scheme' and 'operation'.

The Board of Review derived assistance from the dictionary meanings of 'operation' and 'scheme'. 'Operation' is defined in the *Oxford English Dictionary* to mean action or deed. In the *Shorter Oxford English Dictionary (1933 Edition)*, 'scheme' is defined as meaning—

> "(3) a plan, a design; a project, an enterprise; a programme of work or action to attain an objective ...."

In the *Concise Oxford Dictionary* (8th Edition 1993)—

> "1 a a systematic plan or arrangement for work action etc. **b** a proposed or operational systematic arrangement..."

The Board held, correctly, in my view, that it is not inherent in either definition that the operation or scheme must be carried out by more than one person. That 'transaction' encompasses unilateral transactions or operations is evident from the concluding words of subsection (1) of section 61A which specifically referred to a 'person' entering into or carrying out the transaction. The use of the word 'effected' in the first part of section 61A further reinforces this view.

For my part, I do not see why a change of accounting date, albeit a unilateral act, could not amount to a 'transaction' within section 61A given its wide definition in subsection (3). The Taxpayer whilst reluctantly accepting that the act may be a unilateral act maintains that the act relied upon must at least involve a third party, albeit passively. But I am unable to discern such a requirement or qualification from the language of section 61A itself. The Taxpayer's submission on this point therefore fails.

The seven specified matters

The Taxpayer is not within section 61A unless, having regard to the seven matters specified in paragraphs (a) to (g), it would be concluded that the Taxpayer carried out the transaction for the sole or dominant purpose of enabling it to obtain a tax benefit.

There is little disagreement over the correct approach to section 61A which is to consider each of the seven matters referred to in paragraphs (a) to (g) and not just paragraph (c). Then, having regard only to those matters, one asks the objective question which is whether the sole or dominant purpose considered objectively was to obtain a tax benefit.

Where the parties part company is whether if only paragraph (c) points to the tax benefit being the sole or dominant purpose and the other matters are neutral in that they do not point to a purpose at all, one could objectively conclude that the sole and dominant purpose was to obtain a tax benefit. The Taxpayer submits that paragraph (c) alone is not sufficient. The Commissioner's contention is that it is incumbent upon the Taxpayer to put forward a competing purpose. Where there is no competing or alternative purpose, then it would be legitimate to have regard only to paragraph (c).

The nub of the Taxpayer's submission is that for section 61A to apply, three conditions have to be satisfied, namely, (1) there must be a 'transaction'; (2) the 'transaction' must have the effect of conferring a tax benefit; and (3) having regard to the seven specified matters, it would be concluded that tax benefit was the sole or dominant purpose. If the tax purpose or benefit alone were sufficient, the third condition would serve little purpose. For that reason, the third condition must mean something more than the second condition and therefore something more than paragraph (c) before it could be concluded, objectively, that the obtaining of the tax benefit was the sole or dominant purpose. Further, regard may not be had to the subjective intention of the taxpayer. That being the case, the reasons given by the Taxpayer through its tax representative on 27 July 1993 and set out in paragraph 18 of the Stated Case (viz. that for internal accounting reasons, with a view to reducing some of the pressure on the accounting staff during the tax return submission period and account closing time, the Taxpayer should change its accounting date to enable the accounting work to be spread more evenly over the year) is irrelevant. The Taxpayer invites a strict and literal reading of the seven specified matters. Implicit in this is that it is not incumbent on the Taxpayer to put forward any competing purpose.

Looking at the scheme of section 61A, a conclusion has to be reached on an objective basis as to whether or not the sole or dominant purpose was to obtain a tax benefit by reference to the seven specified matters. Leaving paragraph (c) aside for the moment, in relation to any particular transaction, one or more of the specified matters other than paragraph (c) may not be applicable or may have no bearing upon what conclusion is to be drawn relating to the sole or dominant purpose of the transaction. Nevertheless one or more of the remaining specified matters is bound to be applicable. They may point to a tax purpose or to some other purpose. In this connection, I cannot conceive of circumstances where they point to no purpose at all. It is then incumbent on the Commissioner to reach a conclusion, objectively, whether the tax purpose was the sole or dominant purpose.

It is common ground that whilst not on all fours with Part IVA of the *Income Tax Assessment Act 1936 (Cth) of Australia*, section 61A was modelled on 177D. Australian case law on the operation of section 177D and the approach to be adopted is thus of relevance and in particular, the decision of the Full Court of the Federal Court in **Federal Commissioner of Taxation v. Spotless Services Limited** [1996] 71 ALR 81, a decision relied on by the Taxpayer as well as the Commissioner.

In broad terms, **Spotless**, the taxpayer in that case, invested approximately $40 million in short term investments in the Cook Islands. Although there was no double taxation agreement between Australia and the Cook Islands, the taxpayer claimed that interest was exempt from income tax on the footing that it had been derived in the Cook Islands and that withholding tax had been paid on the interest in the Cook Islands. Whilst the Cook Islands levied withholding tax at the rate of 5% of the amount of interest and the interest rate payable to depositors was approximately 4% below the Australian Bank Bill buying rate, what might be seen as the commercially unattractive aspects of the deposit with the bank in the Cook Islands would be more than offset if the interest were exempt from income tax in Australia. This was the collateral tax advantage which provided the key to the whole transaction and gave it its particular commercial attraction. The Commissioner brought to tax the amounts of interest on the ground that there was a scheme to which Part IVA applied.

The Taxpayer placed reliance on the judgment of McHugh J. After noting that the facts were "very special", being "far removed from the ordinary case of a taxpayer switching an investment from one which had no tax advantages to one from which it would or might obtain tax advantages", McHugh J. observed (at 90) :

> "…. Pt IVA does not authorize the Commissioner to make a determination under par (a) of s 177F(1) merely because a taxpayer has arranged its business or investments in a way that derives a tax benefit. More is required before the Commissioner of Taxation can lawfully make a determination under that paragraph. First, the scheme must be examined in the light of the eight matters set out in par (b) of s 177D. Second, that examination must give rise to the objective conclusion that the taxpayer or some other person entered into or carried out the scheme or a part of the scheme for the sole or dominant purpose of enabling the taxpayer or the taxpayer and some other person to obtain a tax benefit in connection with the scheme. That conclusion will seldom, if ever, be drawn if no more appears than that a change of business or investment has produced a tax benefit for the taxpayer.
>
> The facts of the present case show much more than a switch of investments resulting in a tax benefit. The elaborate nature of the scheme and its attendant circumstances lead inevitably to the conclusion that the scheme was not merely tax driven but that its dominant purpose was to enable the taxpayer to obtain a tax benefit by participating in the scheme. That being so, the appeals must be allowed."

The Taxpayer prayed in aid the observations of McHugh J. set out above since the transaction in question is nothing more than a mere change of accounting date. That made it distinguishable from **Spotless** on the facts.

The Commissioner relied upon the holding of the majority decision of the Full Court. The court, after observing that the reference by Cooper J. in the court below on the one hand to a "rational commercial decision" and on the other to the obtaining of a tax benefit as "the dominant purpose of the taxpayer in making investment" suggested the acceptance of a false dichotomy, stated (at 84D) that :

> "A person may enter into or carry out a scheme, within the meaning of Pt IVA for the dominant purpose of enabling the relevant taxpayer to obtain a tax benefit where that dominant purpose is consistent with the pursuit of commercial gain in the course of carrying on a business."

It went on to hold (at 85 B-C) that :

> "...A particular course of action may be, to use a phrase found in the Full Court judgments, both 'tax driven' and bear the character of a rational commercial decision. The presence of the latter characteristic does not determine the answer to the question whether, within the

> meaning of Pt IVA, a person entered into or carried out a 'scheme' for the 'dominant purpose' of enabling the taxpayer to obtain a 'tax benefit'.
>
> Much turns upon the identification, among *various* purposes, of that which is 'dominant'....." *(emphasis added)*

It is evident from **Spotless** that a consideration of the specified matters would normally point to one or more purposes in addition to a tax purpose. Nor is this surprising. For example, in the present case, a change of accounting date is, *prima facie*, consistent with a business purpose. It is significant that in **Spotless**, consideration of the specified matters meant the consideration of evidence adduced relating to those matters which an objective assessment and evaluation of whether the dominant or sole purpose was for a tax benefit entailed. In **Spotless** itself, the evidence was primarily documentary, consisting of affidavits filed on behalf of both taxpayer and the Commissioner including numerous exhibits. Witnesses were called by both sides and all witnesses were cross-examined : see Lockhart J. in the court below reported in (1993) ATR 344 at 347, ll.26-50.

It is to be noted that in **Spotless**, the Commissioner found four of the eight matters he had to consider in reaching a conclusion on the tax benefit point to be inapplicable. See the report in (1993) 25 ATR at 365, ll.27-30. As Lockhart J explained (at 367), this did not mean that the Commissioner ignored the matters referred to in those paragraphs. It simply meant that having had regard to those matters, the Commissioner saw nothing before him to assist in the conclusion whether or not the requisite purpose existed. The approach advocated by the Taxpayer is plainly not the correct approach. The **Spotless** approach would not involve any question of the taxpayer's subjective intention or purpose. The relevant purpose is ascertained objectively, based on such evidence as may be before the Commissioner or the Board. In the present case, no such evidence was adduced by the Taxpayer.

The Taxpayer was critical of certain passages in the Stated Case, in particular, paragraphs 36, 38(c) and (d) and 39(b) and (c). Mr Flesch Q.C. took issue with the reference to "subjective intention" which he submitted, correctly, has no role in the scheme of section 61A. It may well be, as Mr Herbert Q.C. suggests, that the phrase was meant to refer to "purposes stated". Read in that sense, paragraph 36 is hardly objectionable but those were not the words used. Paragraphs 38 and 39 of the Stated Case dealt respectively with the manner in which the transaction was entered into or carried out and the form and substance of the transaction. The criticisms were, to some extent, justified : at the very least, the language used may have been infelicitous.

In view of the Taxpayer's criticisms, it is the duty of the court to examine the Board's determination having regard to its knowledge of the relevant law. The correct principle is stated by Lord Radcliffe in **Edwards v. Bairstow** [1956] AC 14 at 36 :

> ".... 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....."

Applying that test, notwithstanding the trenchant criticism made by Mr Flesch Q.C. of certain passages of the Stated Case, this is not a case where it can be said that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. The plain fact is that the Taxpayer made no attempt to make good (by adducing relevant evidence) the business or other purpose of the transaction. An example would be the need to harmonize the accounting date for the Group of which the Taxpayer is part. The Board considered and evaluated each and every one of the seven specified matters before reaching a conclusion. On the facts before it, the Board was entitled to reach the determination that it did.

This attack on the Board's decision also fails.

Whether section 61A can override section 18E

This point is premised on the Taxpayer's construction of section 18E being correct. The Taxpayer's submission is that a change of accounting date is expressly provided for in section 18E. Where the section prescribes the consequences of an act, then section 61A cannot override that specific provision.

Mr Flesch Q.C. invited attention to the difference between the Australian legislation and section 61A. In the Australian legislation, there is an express provision — section 177B(1) — to the effect that Part IVA overrides other provisions in the Act. There is no such corresponding provision in section 61A. The omission, he submitted, was deliberate on the part of the draftsman. However, Mr Flesch Q.C. later accepted that such omission could have been due to other reasons, such as sheer oversight.

The Taxpayer relied on the Board of Review's decision in Case D52/86 where, in relation to section 61, the Board held (at 319) that it can have no application because "the tax advantage which is conferred by [section 16(1)(a) (allowing certain deductions of interest)] cannot in our view be withdrawn by [section 61]" and cited three Australian decisions of the mid 1970s in support.

The Commissioner relied on the competing view which is based on the Privy Council decision in **Commissioner of Inland Revenue v. Challenge Corporation Ltd.**

[1987] 1 AC 155 where Lord Templeman, in delivering the judgment of the majority of the court, held (at 164-165) :

> "...Tax avoidance schemes largely depend on the exploitation of one or more exemptions or reliefs or provisions or principles of tax legislation. [The general anti-avoidance provision] would be useless if a mechanical and meticulous compliance with some other section of the Act was sufficient to oust [the general anti-avoidance provision] ... '[it] would be a dead letter if it were subordinate to all the specific provisions of the legislation.'"

The case concerned the acquisition by the taxpayer of the issued share capital in a company which had sustained tax deductible losses in order to reduce the incidence of income tax of the group of companies to which the taxpayer belonged. The subsidiary companies accordingly elected pursuant to section 191(5) for the company's loss to be deducted from their own assessable income. Lord Oliver dissented because in his view, section 191 conferred upon corporate taxpayers an option to regulate their affairs in a way so as to achieve group tax relief. As the general anti-avoidance provision stood together with section 191, if the general anti-avoidance provision were to override, it would instantly deprive the relevant provisions of section 191 of any operation at all. Lord Oliver's approach thus reflected that of the Board in D52/86.

The Commissioner contended that the present case does not contain the difficulty which confronted Lord Oliver because section 18E did not confer any 'right' on the Taxpayer : it merely provides for certain consequences on a change of accounting date. It was also urged that the present case is *not* one of tax mitigation which Lord Templeman explained in the following terms in **Challenge** (at 167H) :

> " Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability. [The general anti-avoidance provision] does not apply to tax mitigation because the taxpayer's tax advantage is not derived from an 'arrangement' but from the reduction of income which he accepts or the expenditure which he incurs."

I confess to having some difficulty in understanding the distinction Mr Herbert Q.C. sought to draw between the benefit in **Challenge** and the present case. The difference, if any, appears to be largely semantic.

In the present case, whether section 61A can override the provisions of section 18E is essentially a question of construction. It is to be noted that section 61A was added in 1986 when section 18E had already been in place a decade earlier. That section 61A can override the other specific provisions of the *Ordinance* is apparent from the wording of section 61A itself. The phrase "*or would have had but for the section*" points to the anti-avoidance provision overriding the other provisions. This would not have been necessary had it been otherwise and I so hold.

Accordingly, on the second of the two questions of law arising, the Board's decision is affirmed.

For the reasons set out above, the Taxpayer's appeal is dismissed and the Commissioner's appeal is allowed. I make an order *nisi* for costs in favour of the Commissioner.

(Doreen Le Pichon)
Judge of the Court of First Instance
High Court

Mr Mark Jeremy Herbert Q.C., inst'd by Department of Justice, for the Appellant in HCIA1/98 and Respondent in HCIA2/98

Mr Flesch Q.C. and Mr Sujanani, inst'd by M/s Ford, Kwan & Co., for the Respondent in HCIA1/98 and Appellant in HCIA2/98