INLAND REVENUE BOARD OF REVIEW DECISIONS

CACV 313/1998

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF APPEAL

CIVIL APPEAL NO. 313 OF 1998

(ON APPEAL FROM INLAND REVENUE APPEALS
NO. 1 AND 2 OF 1998 (Consolidated))

BETWEEN

YICK FUNG ESTATES LIMITED Appellant

and

THE COMMISSIONER OF INLAND REVENUE Respondent

Coram : Hon Godfrey and Rogers, JJA and Woo, J in Court
Date of hearing : 3, 4 and 5 November 1999
Date of handing down judgment : 3 December 1999

J U D G M E N T

Rogers, J.A. :

Introduction

This is an appeal from a judgment of Mrs Justice Le Pichon given on 30 October 1998. The proceedings before the Judge below were 2 consolidated Case Stated appeals from the Board of Review pursuant to section 69 of the Inland Revenue Ordinance, Cap 112.

The Appellant, Yick Fung Estates Limited, the Taxpayer, commenced business prior to 1 April 1974. Until the year of assessment 1988/89, its accounting date was the 30 June each year. In that year of assessment, it changed its accounting date to the 31 March. Following that change, the assistant commissioner raised a Second Additional Profits Tax Assessment for the year 1988/89 and sought to tax the Taxpayer on additional profits of $108,327,586 which had been earned in the 9-month period from the end of the preceding accounting period to the end of the new accounting period. This made a total period of 21 months which was treated as the basis period for the computation. The profits for the relevant years are summarised 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

On behalf of the Commissioner, it is said that the tax assessment was liable to be raised both under the provisions of section 18E of the Ordinance and alternatively on the basis of section 61A.

The Taxpayer took its case to the Board of Review. The Board decided, as a matter of statutory construction, that the Assessor was not entitled to use a basis period of more than 12 months but that the change of accounting date in the year of assessment 1988/89 was a transaction caught by section 61A of the Ordinance and the assistant commissioner exercising the power under that section was entitled to raise the assessment.

Both sides were dissatisfied with the decision of the Board and requested cases to be stated.

The question of law posed on behalf of the Commissioner of Inland Revenue was :-

> "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."

(This has been referred to as the "construction point".)

The question of law posed on behalf of Yick Fung Estates Limited was as follows :-

"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 Judge below decided both issues in favour of the Commissioner and this appeal is made from that decision.

The construction point

The determination of the construction point turns upon section 18E of the Inland Revenue Ordinance. That reads as follows :-

"18E(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) where the accounts of any trade, profession or business are made up to the end of the Lunar year, the Commissioner may accept those

accounts as being made up to a corresponding day in each year of assessment; and

(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.

(3) For the purposes of this Part, where in the case of a trade, profession or business it is necessary in order to arrive at the assessable profits or the losses for any year of assessment to divide or apportion to specific periods the profits and losses for any period for which accounts have been made up, or to aggregate any such profits or losses or any apportioned parts thereof, it shall be lawful to make such division and apportionment or aggregation, and any such apportionment shall be made in proportion to the number of days or months in the respective periods unless the Commissioner, having regard to any special circumstances, otherwise directs.

(4) For the purposes of section 18D(2A), where in the case of a trade, profession or business it is necessary in order to arrive at the profits or losses for any period to divide or apportion to specific periods the profits and losses for any period for which accounts have been made up, or to aggregate any such profits or losses or any apportioned parts thereof, the Commissioner may make such division and apportionment or aggregation as he may deem proper in that case."

The purport of the arguments on each side can be summarised as follows :-

There is no dispute that at least the condition in section 18E(1)(a) is satisfied and that in those circumstances, the Commissioner has a discretion to compute the assessable profits as he thinks fit in relation to the year of assessment under section 18E(1)(i) and to recompute the assessable profits as he thinks fit in respect of the preceding year under subsection (ii). For the Commissioner, it is said that that discretion is unlimited and in those circumstances, the Commissioner is entitled to raise an assessment which will bring within the tax net all the profits which have been made by the Taxpayer.

The major argument on behalf of the Taxpayer is that profits tax is an annual tax and that although the words "(re)computed on such basis as the Commissioner thinks fit" give a broad discretion to the Commissioner, they cannot be read as unrelated to the year of assessment which is the basis for profits tax. Heavy reliance in this respect was placed upon the judgments of Nolan, J and

Lord Oliver in the case of *R v Commissioners of Inland Revenue ex parte Woolwich Equitable Building Society* 63 TC 589. This case was not before the Judge below and the emphasis which is now placed in the arguments on behalf of the Taxpayer on the concepts underlying the passages relied on must have been markedly different. The Taxpayer further points to the provisions of section 18E(2)(b) which specifically give the Commissioner power to make a computation on the basis of a period in excess of 12 months in respect of businesses commenced on or after 1 April 1974. It is said that the absence of any corresponding provision in relation to businesses which were commenced before the 1 April 1974 also leads to the conclusion that it is illegitimate for the Commissioner to use a basis period of longer than 12 months.

The history of the legislation

The words empowering computation "on such basis as the Commissioner (in his discretion) thinks fit" clearly were present in the pre-1975 legislation. In view of the fact that the issue between the parties is as to the effect of the present legislation in relation to companies which were governed by the pre-1975 legislation it is, in my view, relevant to consider that legislation to see whether any assistance can be derived as to the meaning of those words in their original context. That consideration has led to the conclusion that in its original context, those words gave the Commissioner a discretion which was limited in the manner argued on behalf of the Taxpayer. Nevertheless, that is not necessarily conclusive of the matter. Indeed, the various changes to this part of the Ordinance have resulted in a situation where those words as used in section 18E cannot be limited in their effect to a situation where the basis period can only be 12 months.

The history

(1) The War Revenue Ordinance

The origins of sections 18 to 18F of the current Ordinance can be traced at least to the War Revenue Ordinance 1940. Profits tax was dealt with in Chapter IV; the predecessor of the current relevant sections was section 18. It was a shorter section and read as follows :-

> "18(1) The profits derived from any trade, profession or business carried on in the Colony for each year of assessment shall be the full amount of the profits which arose or accrued from transactions within the Colony of such trade, profession or business during the year preceding the year of assessment.
>
> (2) Where the Commissioner is satisfied that the accounts of a trade, profession or business carried on or exercised in the Colony are usually made up to some day other than the thirty-first day of March, he may direct that the profits from

> that source be computed on the amount of the profits of the year ending on that day in the year preceding the year of assessment. Where, however, the profits of 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 profits from that source both of the year of assessment in which such failure occurs and of the two years of assessment following shall be computed on such basis as the Commissioner in his discretion thinks fit.
>
> …
>
> (4) Where in the case of any trade, profession or business it is necessary in order to arrive at the profits or losses of any year of assessment or other period to divide and apportion to specific periods the profits or losses for any period for which accounts have been made up, or to aggregate any such profits or losses or any apportioned parts thereof, it shall be lawful to make such a division and apportionment or aggregation, and any apportionment under this section shall be made in proportion to the number of days in the respective period."

It will be noted that the tax is raised for the year of assessment on the basis of the profits of the preceding year. If accounts were normally made up to some date other than the 31 March, the Commissioner was empowered to use those made up to that day in the preceding year as the basis of the assessment. It may also be noted that the second sentence of subsection (2) relates only to accounts not being made up to a corresponding day in the following year but the section does not contain the equivalent of subsection 18E(1)(b), i.e. it did not extend to a situation where accounts are made up to more than one day in a year of assessment.

Considering subsection (4), it might appear that the reason for its inclusion would be to allow the Commissioner to calculate the profits (or losses) where no account is made up to a corresponding day. The requirement that any apportionment should be made in proportion to the number of days in the respective period, on its face, left no room for flexibility. It might seem that the reason for the inclusion of subsection (4) would be that where the second sentence of subsection (2) came into effect, the Commissioner would attempt to arrive at the profits (or losses) of a year in respect not only of the year in which there was a failure to make up the relevant accounts but also the two subsequent years. No doubt, the Commissioner would be able to pick any period of a year, having made the necessary calculations, from the relevant period for which accounts were available on which the profits for the year of assessment could be fixed.

(2) The Inland Revenue Ordinance 1947

The War Revenue Ordinance was only passed in April 1940 and thus clearly did not have a long period for its application. The Inland Revenue Ordinance came into effect on 2 May 1947 and contained similar provisions to the War Revenue Ordinance. Section 19(1) read :-

> "19(1) Save as provided in this section, the assessable profits liable to Profits Tax of any trade, profession or business for any year of assessment shall be the full amount of its profits arising in or derived from the Colony during the year preceding the year of assessment: Provided that for the year of assessment 1947/48 a person assessable to Profits Tax, by giving notice in writing to the Commissioner on or before the thirty-first day of March, 1949, may require that his assessment be adjusted to the profits arising during that year of assessment."

Subsections 19(2) and (7) reproduced respectively subsections 18(2) and (4) of the War Revenue Ordinance and subsections (3), (4), (5) and (6) read as follows :-

> "(3) Where a person commences to carry on a trade, profession or business in the Colony on a day within a year of assessment, the profits arising therefrom for the period from such date to the end of the year of assessment shall be the assessable profits for such year of assessment.
>
> (4) Where a person has commenced to carry on a trade, profession or business on a day within the year preceding a year of assessment, the assessable profits for that year of assessment shall be the profits for one year from such day.
>
> (5) Where a person ceases to carry on a trade, profession or business, the assessable profits therefrom as regards the year of assessment in which the cessation occurs shall be the amount of the profits of the period beginning on the first day of April in that year and ending on the date of cessation.
>
> (6) Notwithstanding the provisions of section 71 a claim made under subsections (2), (3), (4) or (5) of this section to an adjustment of any assessment by reference to the profits for any period other than the year preceding the year of assessment shall be entertained if it is made within the period of twelve

> months next succeeding the year of assessment. A claim so made shall be regarded as an appeal for the purposes of Chapter XI."

It would seem from the wording, particularly of subsection (1), the first sentence of subsection (2) and subsections (4) and (6) that it was intended that it would be a year' s profit that would form the basis of assessment. Hence, the conclusion derived : that in exercising his discretion under the second sentence of subsection (2) that the Commissioner would calculate periods of a year, would be the same in respect of this Ordinance as it was in respect of the War Revenue Ordinance.

The subsequent history of the legislation at least up until the enactment of the section with which this case is concerned, in my view, confirms the annual nature of the basis period for the assessment of profits tax.

(3) The 1951 Amendments

The proviso to subsection (1) was removed in 1950. In the following year, provisos were added to subsections (4) and (5) of the Ordinance as follows :-
Subsection (4) :-

> "Provided that such person may claim, by giving notice in writing to the Commissioner, to have his assessable profits for that year of assessment and for the following year of assessment (but not for one or other of those years) adjusted to the actual profits for each such year respectively."

Subsection (5) provided that :-

> "Where the profits of the year of assessment immediately preceding the year in which the cessation occurs exceed the amount of the assessment in respect of that preceding year such assessment shall be increased to the amount of profits for that preceding year and an additional assessment shall be made."

It would be noted that by this time, the relevant section had reverted to being section 18, no doubt by reason of editorial amendments which the editor of the Laws of Hong Kong was empowered to make. It would also be noted that, particularly in respect of the proviso to subsection (5), the re-computation was to be made on the basis of the actual profits arising in or derived from Hong Kong during the preceding year and that there was no apparent discretion in the matter.

Again, the conclusion on reading the Ordinance at this stage would be that profits tax was an annual tax to be assessed on the basis of a year' s profit, namely the preceding year' s profit (except when subsection (5) or the proviso to that subsection applied) and there was no apparent

warrant for the inclusion of profits of a basis period in excess of a year. The discretion included in subsection (2) was thus, presumably, one empowering the Commissioner to select the period of one year which he considered the most appropriate.

(4) The 1955 Amendments

Substantial amendments were made to the Inland Revenue Ordinance by the Amendment Ordinance No. 36 of 1955. Insofar as they impinged upon section 18, they involved, in the first place, the inclusion of the word "assessable" before the word "profits" in each of sections (2) to (7) inclusive. Although there had been a definition of the expression "basis period" included in the original Ordinance, the new definition of assessable profits which was included by the 1955 amendments did not include a reference to the expression "basis period". Assessable profits was defined as meaning the net profits for any period arising in or derived from the Colony calculated in accordance with the provisions of Part IV but does not include profits arising from the sale of capital assets.

There was also included two sections: 18A and 18B. They were as follows :-

"18A Corporation profits tax shall be charged for each year of assessment at the standard rate on the assessable profits of a corporation for that year ascertained in accordance with the provisions of this Part.

18B Business profits tax shall, subject to the provisions of subsection (2), be charged for each year of assessment at the standard rate on the assessable profits of a person other than a corporation for that year ascertained in accordance with the provisions of this Part."

Section 18B(2) related to relief where the amount of profits was small.

It will be seen, both in relation to sections 18A and 18B, that the assessable profits would, following through the definition, be ascertained in accordance with Part IV, particularly, therefore, section 18 itself, thus indicting that the relevant basis period for assessing profits was a one-year period.

(5) The 1956 Amendments

The Inland Revenue (Amendment) Ordinance, No. 49 of 1956 contained, amongst other things, a re-draft of section 18. The re-draft appears to contain changes in wording which were

largely stylistic but does not contain any basic change to the relevant provisions of the Ordinance. Subsection (1) of section 18 was changed to read :-

> "(1) Save as provided in this section, the assessable profits for any year of assessment from any trade, profession or business, carried on in the Colony shall be computed on the full amount of the profits therefrom arising in or derived from the Colony during the year preceding the year of assessment."

There was one change to the end of the first sentence of subsection (2) where the wording was changed to read "..on the amount of profits arising in or derived from the Colony *during* the year ending on that day in the year preceding ..". Thus, if anything, this latter change would emphasise that the assessment period was a yearly period. In relation to subsection (7), a discretion was added in the form of the final words which read "..unless the Commissioner having regard to any special circumstances, otherwise directs."

As part of these amendments, the words "any period" were removed from the definition of "assessable period" and were replaced by the words "the basis period".

(6) The 1971 Amendments

The distinction between corporation and business profits tax appears to have been removed in 1971 and sections 18A and 18B were then removed. Although these sections, when inserted into the Ordinance, were, in my view, confirmation of the annual basis of assessment of profits for the purposes of tax, the circumstances of their removal point simply to the removal of the distinction between the two types of profits tax and not to any change in the basis of the assessment.

Drop-out

Before turning to the 1975 amendments, it would be appropriate to mention the question of "drop-out". This is an expression which has been used to describe the phenomenon which occurs when profits of a particular period are not used for the basis of calculation of profits tax. The most obvious drop-out occurred in case of cessation where a business had been making up accounts other than to the 31 March. A consideration of subsection 18(5) as it existed immediately prior to the 1975 amendments shows that there would have been drop out of the profit in the period between the end of the accounting period for the year of assessment prior to the cessation and the 1 April of that year. No doubt to prevent blatant manipulation of the profit figures for the period leading up to cessation, the proviso was added which enabled the Revenue to assess tax on the profits of the year later than it otherwise would have done in respect of the year of assessment prior to cessation, if that was beneficial to the Revenue.

Another form of drop-out would take place if and when there was a change of accounting date. Again, no doubt to limit manipulation of the period when the profits were shown, the Revenue was empowered to look at the year of change and the two following years and again adjust the assessment in a manner that seemed appropriate.

There was no apparent connection, however, between the drop-out that would occur on the cessation of business and the drop-out that would occur on change of accounting date. Indeed, also, the statutory mechanism which appears to have been put in place to prevent abuse was different in each case. In the case of cessation, the Revenue in effect had a choice of the earlier or later year' s profits. In the case of change of accounting dates, the Revenue could pick any periods that it considered appropriate. But in my view, for the reasons I have given, that would be subject to those periods being periods of a year.

(7) The 1975 Amendments

The Inland Revenue (Amendment) Ordinance No. 7 of 1975, introduced substantial changes in relation to profits tax. The most notable change was that tax was to be assessed on the current year basis and not, as previously, on the preceding year basis.

Section 18 itself was left largely unchanged save that the previous subsection (7) was deleted although it was, in effect, repeated in a later subsection, namely section 18E(3). In its place, there was a new subsection (7) which provided that section 18 would apply to the years of assessment up to and including the year of assessment commencing on 1 April 1974.

The new section 18B set out the basic provision that profits for the year of assessment commencing on or after 1 April 1975 "..be computed on the full amount of the profits therefrom arising in or derived from the Colony during the year of assessment."

The transitional arrangements for the year of assessment 1974/5 were contained in section 18A and in effect provided that the basis period for the assessment of the tax for that year would be the higher of either the preceding or the then current year. As can be imagined, in a situation where assessment is changed from being based on the preceding year' s profits to the current year' s profits there would, inevitably, be a period of drop-out. In this case, the transitional provisions in section 18A provided that it would be the year with the lower profit.

In respect of those businesses which commenced on or after 1 April 1974, there was no option but that the profits would be assessed on the current year basis : section 18C.

Section 18D provided the rules relating to cessation of business in any year of assessment commencing on or after 1 April 1975.

Subsection 18D(1) provided the basic rule that the profits which were generated from the day following the end of the basis period for the preceding year and ending on the date of cessation would be the relevant amount.

Subsection (2), however, related to businesses which had commenced prior to 1 April 1974. In respect of those businesses, the basis for computation would be the profits from the 1 April in the year of cessation until the date of cessation. That special rule was doubtless intended to preserve the existing right in respect of businesses commenced before 1 April 1974 which had been contained in section 19(5) of the 1947 Ordinance and had continued through to section 18(5) of the then current Ordinance. The proviso which had been included in the 1951 amendments, presumably to prevent excessive abuse, was curiously absent.

Section 18E which I have set out at the commencement sets out the provisions relating to the change of accounting dates. It can be noted that the title given to the section is "Change of accounting date and apportionments." The first point to be noted is that in contrast to section 18(2), the trigger for the section to operate is not only that accounts are not made up to a corresponding day in the following year but also, under subsection (1)(b), if the relevant person makes up accounts to more than one day in the following year of assessment. The next point to be noted is in relation to the years in respect of which the profits for the purposes of profits tax may be affected. In contrast to section 18(2) whereby the Commissioner was empowered to compute the assessable profits, not only for the year of assessment but for the two years following, under subsection 18E(1)(ii), the assessable profits for the year preceding the relevant year of assessment shall be re-computed if the Commissioner thinks fit.

As has already been noted, section 18E(2)(b) provides that for businesses commenced on or after 1 April 1974; the Commissioner was entitled to make a computation in respect of a basis period which exceeded 12 months. There would thus be no "drop out" in respect of those businesses when they changed their accounting date since all the profits made by post-March 1974 businesses were likely to be assessable for profits.

Finally, as has already been noted, subsection 18E(3) reproduces the old section 18(7). This would give the impression that those who were responsible for 1975 amendments also considered that the previous section 18(7) had related to computation rendered necessary following a change in accounting dates. Thus, credence would be given to the supposition that the Commissioner would be aiming to assess a year' s profits if necessary, making calculations based on a hypothetical basis that profits were evenly distributed on a daily basis throughout each accounting period.

As indicated above, it might be supposed that the intention in the earlier legislation had been that the basis period for calculation of profits assessable for tax would be no longer than one year and if necessary, the Commissioner would be required to make the necessary adjustments in calculations.

However, a consideration of subsection 18E(1) might raise a query as to whether that notion as to interpretation would still hold good. Whereas, subsection (1) repeats the same power for the Commissioner to compute profits for the current year, it is not the subsequent years as in section 18(2) which were to be (re)computed but the preceding year. The only way in which the profits for the preceding year could be re-computed would be by taking a period which was other than a year as the basis period.

It will be remembered that the trigger for the operation of the section is that the relevant accounts are either not made up to a corresponding day in the following year of assessment or are made up to more than one day in that year. On neither basis, would there be any suggestion that the accounts for the previous year had, at the time, not been properly made up. In accordance with the other provisions of the Ordinance, they would have been made up for the period of one year. The only apparent way in which they could be re-computed would thus be either to make them up for a more lengthy period or for a shorter period. Since subsection (1) now encompassed situations where accounts were made up to more than one day in the following year of assessment, the Ordinance now encompasses situations where the accounting date would have been brought forward as well as situations where the accounting date was unquestionably delayed. In cases where the accounting date in the following year was brought forward, clearly there would be scope for contracting the basis period of at least one of the years to a period shorter than one year. In such a situation, the provisions of subsection (3) would be operable and the Commissioner would be entitled to calculate the appropriate profit for the shorter period based on a simple assessment of the proportion of the number of relevant days.

The question then arises as to whether in relation to pre-April 1974 businesses when the accounting date is delayed, the words "on such basis as the Commissioner thinks fit" should be construed to include computations in respect of a basis period which exceeds 12 months. Clearly, on the face of the wording as used in subsection (1), that would be a possibility since subsection (2) is drafted on the basis that those words, albeit in relation to post-March 1974 businesses, could bear that meaning. However, I incline to the view that the inclusion of section 18E(2)(b) by making specific provision for the profits of post-March 1974 businesses to be calculated on a basis period exceeding 12 months by implication continues previously existing arrangements in respect of pre-April 1974 businesses in the same way that the cessation rules in respect of pre-April 1974 businesses were

retained (at least insofar as they benefited the Taxpayer). In both cases, the effect of these provisions could entail periods "dropping out" of assessment, as has been referred to above.

(8) The 1980 Amendments

The Inland Revenue (Amendment) (No. 2) Ordinance of 1980, No. 34 of 1980 introduced a new section (2A) to section 18D and a subsection (4).

As the Judge below noted, subsection (2A) is complex in its design which makes it difficult to follow on first reading, but as all parties accept, its effect is stated in Flux on Hong Kong Taxation 1998/99 edition at p. 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 1 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."

In effect, therefore, what is accomplished by this section is that in respect of pre-April 1974 businesses in the case of cessations occurring on or after 1 April 1979, the benefit of subsection 18D(2) shall, as regards the amount of profits which would otherwise drop out by virtue of that subsection in the computation of assessable profits for the year of cessation, cease to apply to the extent that the amount exceeds the corresponding amount which would have dropped out if the cessation had occurred at the end of the relevant basis period for the tax year 1975/76 assessment. No doubt, there had been manipulation of dates of cessation which prompted this amendment. It can be envisaged, for example, that in respect of single project companies, the gaining of major profits, possibly from the sale of developments, might well take place about a year or so prior to cessation and the cessation date for trading could easily be manipulated in order to secure the best tax advantage.

It is noteworthy that subsection 18E(4) which was inserted by these amendments was similar in wording and in large part corresponded to the old section 18(7) and the new section 18E(3) but related only to section 18D(2A).

The Judge below rightly, in my view, rejected a convoluted argument raised on behalf of the Taxpayer that all the Taxpayer was doing was accelerating the time when the benefit of a drop-out which would be received on cessation, was taken. In my view, the two periods of potential drop-out, i.e. that on cessation and that on change of accounting date, had nothing to do with each other.

It may well be that the consideration behind the original section 18D(2) was deliberately to permit a drop-out period on cessation for a pre-April 1974 business, because that business would, at its inception, if its accounts were not made up to 31 March, have had its tax assessed for more than one year on the basis of profits made in its initial period of trading. That may be so, although I am inclined to the view that that arrangement was possibly for the benefit of the taxpayer since in the initial year of its trading, no doubt its profit was less than it would be in later years. Nevertheless, I cannot see how this argument, on the part of Taxpayer, can apply since now the provisions of section 18D(2A) restrict the benefit on cessation to the same amount as the business would have benefited if it had ceased trading in the 1975/76 assessment period when the amendments were brought into effect and it had, in effect, started over again.

Whether or not the potential manipulation of accounting dates to achieve a similar effect as could be achieved by manipulation of a cessation date was appreciated in 1980 when section 18D(2A) was enacted is simply a matter of conjecture.

(9) The 1986 Amendments

In 1986, the provisions of section 61A which could be classified globally as tax avoidance provisions were brought in. This was part of other alterations which appear to have been designed to make it more difficult to avoid or limit tax liability.

I concur with the Judge below that it was right to have reference to the history of the legislation, in particular, the contents of the provisions which had affected the pre-April 1974 businesses. But the Judge's attention was not drawn, as indeed our attention was not drawn, to the detail of the legislative history which I have referred to above. In particular, it was not drawn to attention that there had been no reference in section 18 as originally drawn to assessable profits nor to the basis period. The reference was to yearly periods. The definition of assessable profits which was included in 1955 was only amended by the 1956 legislation to have reference to "basis period" at which time the change, as I have indicated, of the wording of section 18(2) to include the words "during the year" was inserted and the previous sections 18A and 18B were present. Viewed in this light, the existing arrangements had clearly been based upon any computation being in respect of a year's period. The new enactment in 1975, in my view, did not change this.

In the light of the above analysis, I consider that what Lord Oliver said in the *Woolwich* case, p. 621 is equally applicable in the present circumstances :-

> "the suggested inhibition against such cumulative taxation lies not only in the words which Parliament has chosen to use but in certain well-established presumptions or principles – a presumption against double taxation, a presumption that income tax, being an annual tax is payable only on the income of a particular year and so on."

Lord Oliver went on to say :-

> "But these are only presumptions, they are clearly rebuttable if sufficiently clear express words are used. But they can also be rebutted, as it seems to me, by circumstances surrounding the enactment for particular legislation which led to an inevitable inference that Parliament intended in using the words that it did, that these presumptions or principles should not apply."

Applying that to the present situation, in my view, the conclusion which is reached is that profits tax is indeed a yearly tax and that there would be a presumption that it is payable on yearly profits. The wording of the Ordinance does not displace that presumption in the present circumstances; nor, as I see it, do the circumstances surrounding the legislation lead to an inference that it was not intended that profits tax was an annual tax to be levied on a computation of annual profits.

My conclusion in respect of the construction of section 18E is arrived at in the light of the considerable difficulty posed by the strong countervailing arguments which can be arrayed because of the presence of subsection (2)(b). On the one hand, that subsection can be said to widen the scope of the discretion under subsection (1) or put in another way, subsection (1) must, of its nature, comprehend within it subsection (2)(b) and on the other hand, it could be said that there would be no reason for the inclusion of subsection (2)(b) if the discretion under subsection (1) included the power of computing the profits on the basis of more than 12 months.

In the end, I have reached my conclusion primarily on the basis that it had not been the law prior to the 1975 amendments that a basis period of longer than 12 months could be adopted, that there was no intention shown to change that and had the discretion under subsection (1) always been, as argued by the Commissioner, there would have been no need for the inclusion of subsection (2)(b), which would be otiose.

<u>The tax avoidance point</u>

The question raised by the case stated in relation to the tax avoidance point turns entirely upon section 61A of the Ordinance. Subsection (1) reads 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 person (in this section referred to as ' the relevant person'), 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 person 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."

Transaction is defined as including "a transaction, operation or scheme whether or not such transaction, operation or scheme is enforceable, or intended to be enforceable, by legal proceedings". Both the Board and the Judge below decided the question raised in favour of the Commissioner.

On this appeal, Mr Flesch, QC on behalf of the Taxpayer, argued four points, all of which had been argued before the Board and one point, which turns upon the assessment of 21 months profits, is raised again in this Court, although, we were told, was not argued in the Court below.

(1) Whether there was a "transaction"

As referred to above, section 61A(3) defines a "transaction" as including "a transaction, operation or scheme whether or not such transaction, operation or scheme is enforceable, or intended to be enforceable, by legal proceedings". The major point taken on behalf of the Taxpayer is that the word "transaction" implies that there are at least two parties to whatever act is identified as a transaction. It is said that this is made clear by reference to the enforceability of the transaction by legal proceedings. It is said that transactions which fall within this definition would be a complicated series of acts and something far more intricate than a change of accounting date.

In my view, the change of accounting date, involving the preparation of the Taxpayer's accounts to March 1989 instead of June 1989 clearly constitutes either a scheme or operation such as would cause it to fall within the definition of transaction.

It would also be apparent that the concluding words of subsection (1) where it is said that "..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" demonstrate the possibility of the existence of a sole protagonist.

There is, in my view, no need for two parties to be involved and, indeed, section 61A(3) makes it clear that legal enforceability of a transaction is not an absolute requisite.

Whilst the dictionary definition of scheme referred to by the Judge below is of assistance, the various cases cited being decisions in respect of other legislation, containing other definitions, are, in my view, of very little assistance in arriving at a conclusion as to the meaning of the word as used in the present Ordinance. I have to say that I see very little merit in this point at all.

The second objection - The seven specified matters

There is no, and has, as far as can be seen, been no, dispute between the parties that the words "…it would be concluded that …" and indeed, the structure of subsection (1) lead to the conclusion that the tests set out in section 61A have to be applied objectively.

There are seven matters (a) to (g) to which the section requires that regard must be had. On a clear construction of the subsection, the section would not be relevant or the subject matter of consideration unless there was a tax benefit, in other words, the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof. In this case, it is said that there has been an avoidance of tax in respect of HK$108,327,586 profits or at any rate, there has been a reduction in the amount of tax that would otherwise have been payable. On that basis, the various matters at (a) to (g) have to be considered and if upon that exercise, the conclusion would be arrived at that the person who entered into or carried out the transaction did so for the sole or dominant purpose of obtaining a tax benefit, the assistant commissioner may exercise one of the two powers set out in subsection (2).

In this Court, there was some discussion as to whether it is necessary for more than one item in matters (a) to (g) to indicate the sole or dominant purpose for it to be possible that that conclusion be arrived at. In my view, the posing of the question itself possibly indicates an erroneous approach to the section. Clearly, what must happen is that those matters must be considered and the strength or otherwise of the various resulting conclusions from considering those matters must be looked at globally. On the basis of that assessment, it must be decided whether the sole or dominant purpose was the obtaining of a tax benefit. It may be observed, for example, that one or other of the matters in (a) to (g) may be strongly or weakly suggestive of a purpose of obtaining a tax benefit or may be strongly or weakly suggestive of some other purpose. The assistant commissioner who undertakes such task has to use his own common sense and apply the results of his deliberations in respect of each matter and come to an overall conclusion.

Taking the matters in turn, I would comment as follows :-

(a) The manner in which the transaction was entered into or carried out

The first matter which arises on that is that the criteria appears to be entirely open. The manner may encompass many things. But I agree with Mr Herbert, QC, appearing on behalf of the Commissioner, that it includes the time and timing of whatever transaction is under consideration.

In the present case, as the Board remarked at paragraph 38(c) of the Case Stated, the timing of the transaction, namely the change of accounting date, occurred at a time when the Taxpayer

was enjoying substantial profits. In terms of the overall profit history of the Taxpayer which is set out in paragraph 19 of the Case Stated, it would appear that the change in accounting date occurred at a time when the Taxpayer was enjoying the peak of its profits from a development whereof the profits could only be expected to last, at those levels, for a year or so more. In summary, the profits of HK$108,327,586, in the period which is disputed, would appear to amount to some 14.87% of the total profits shown.

In my view, the manner in which the change of accounting date was entered into was indicative of the obtaining of a tax benefit.

(b) The form and substance of the transaction

The Board approached the matter on the basis that the word "form" related to the legal effect or, as I would put it, the legal nature of the transaction and that the substance related to the practical or commercial end result of the transaction. In that respect, I would have no cause to disagree with the way in which this was put.

There had been suggestions which are referred to, both in the Case Stated and in the judgment below, that the change of accounting date was to assist the group accounting. That suggestion was not pursued in the evidence. As the Judge said at page 24 of her judgment, the evidence of the need to harmonise the accounting date for the Group would be an objective fact. On the other hand, of course, evidence that the Taxpayer made the change to harmonise and for no other reason would be subjective. The distinction might be small, but if it is borne in mind when scrutinising the evidence and weighing the facts, there is no reason why appropriate facts cannot be taken into consideration.

Paragraph 36 of the case stated was heavily criticised on behalf of the Taxpayer. It was said that it clearly showed that a wrong approach had been made because the Board showed a propensity to admit evidence of subjective intention when the section required an objective test. However, an objective assessment cannot be made in a vacuum. Evidence of relevant facts is not only admissible but essential in order to make an objective assessment as to what happened. If the Board had said that they were applying a subjective test, then the criticism would have had more force. But if the Board was suggesting, as I consider is the case, that evidence of subjective intention could be analysed insofar as it indicated the objective facts, then the statement is not so objectionable. I would agree with the Judge below however that some of the language used in the Case Stated was infelicitous.

Indeed, other paragraphs in the Case Stated were subject to criticism by Mr Flesch, for example, paragraph 39(b) on page 20 of the Case Stated. On close analysis, however, I consider that what the Board were saying was that their assessment of the facts led to the conclusion that the

objective assessment of the commercial reality of the transaction was that it was an attempt to avoid the bringing of a substantial sum into account for profits tax.

In any event, in relation to much of the criticism, there was no subjective intention on the part of the Taxpayer which was taken into account and so the point, insofar as it has been taken, is to that extent a hollow one.

(c) The result in relation to the operation of this Ordinance that, but for this section, would have been achieved by the transaction

There is no dispute that this point shows heavily against the Taxpayer on any analysis. The only real point as to this is the argument on behalf of the Taxpayer that the Commissioner could not succeed if it was only this point which told on behalf of the Revenue. In my view, this is not the situation here but, leaving aside the question of whether the question itself is the wrong question to ask, as a theoretical point, I see no reason why if all other points were neutral, in an appropriate case, this point alone could not suffice to bring section 61A into operation.

The other points in section 61A would appear, if anything, as held by the Board, to be marginally in favour of the Taxpayer. Furthermore, I agree with the approach of the Judge below. Even on the basis that the decision of the Board were open to review on the basis of the principle expressed in *Edwards v Bairstow* [1956] AC 14 at p 35, in my view, the correct conclusion is that the Board' s ultimate decision on this matter was correct.

Whether section 61A can override section 18E

There were really two points taken on behalf of the Taxpayer under this heading. It was said that in the absence of any express provision, section 61A could not override the right to change an accounting date which was given by section 18E. In this respect, heavy reliance was placed upon a comparison with the Australian legislation. Whilst the Australian legislation is of some interest, it is noteworthy that there was a change in the Australian legislation and the earlier decisions are even more remote from the factors relevant in respect of the present case. The "choice principle" was encapsulated in the Judgments in *WP Keighery Pty Ltd v Federal Commissioner of Taxation* [1956 – 1957] 100 CLR 66; see, for example, the passage in the judgment of Dixon, CJ, Kitto and Taylor, JJ at p.92 :-

> "Whatever difficulties there may be in interpreting section 260, one thing at least is clear : the section intends only to protect the general provisions of the Act from frustration, and not to deny taxpayers any right of choice between alternatives which the Act itself lays open to them."

But even if it applied, I do not see that there is any such choice which is given in the present Ordinance. Insofar as any right is conferred by section 18E to change accounting dates, it is clear that when that happens, there is a discretion given under subsection (1)(i) and (ii) and the Commissioner is given on any footing a broad discretion. In my view, the Judge below was correct : Insofar as section 18E does contemplate a change in accounting date, that is something which comes within the options recognised by the Ordinance. Nevertheless, the wording of section 61A(1) "..that transaction has, or would have had but for this section, the effect ..". makes quite clear that section 61A has an overriding effect. In the final analysis, the transaction could only take "effect" in the context of the Ordinance itself.

Then a comparison was drawn with the Australian legislation and it was said that the Australian legislation had a specific provision overriding other provisions as well as the equivalent of the wording I have quoted above. The fact that legislation in Australia now includes a specific provision which puts the point beyond any argument does not, it seems to me, affect the proper construction of this Ordinance and this section.

The section 61A assessment is not within the scope of the Ordinance

This submission has been renewed in this Court despite the fact it was not argued in the Court below, although it was argued and rejected by the Board. The fundamental argument is based in part upon the *Woolwich* case that because profits tax is an annual tax, it is an illegitimate exercise of any discretion for the Revenue to proceed under section 61A(2)(b) and to assess the profits for a 21-month period in one year of assessment. It seems to me that once the assistant commissioner has formed the view that there has been a tax benefit resulting from a 9-month period not being taken into account, he is perfectly entitled to counteract the tax benefit in any manner he considers appropriate and there is nothing inappropriate in ensuring that that 9-month period becomes subject to profits tax. In my view, this ground fails as well.

Conclusion

In conclusion, therefore, I consider that this appeal should be dismissed with an order nisi that the costs of the Respondent to be taxed and paid by the Appellant.

Woo, J :

I have had the advantage of reading the judgments of both Godfrey and Rogers, JJA in draft. I agree with the conclusions reached by them and the reasons therefor. I would also dismiss the

appeal and make an order nisi that the Appellant do pay the costs of this appeal to the Respondent, to be taxed if not agreed.

Godfrey, JA :

Introduction

I agree with the conclusions of Rogers, JA as to the effect in this case of (1) section 18E of the Inland Revenue Ordinance, Cap 112; and (2) section 61A of that Ordinance. I shall briefly state my own reasons, dealing with these two statutory provisions in turn.

Section 18E

The power which the Commissioner of Inland Revenue has sought to exercise here in relation to the taxpayer must be some power *other* than that conferred on him by section 18E(2)(b). The power conferred on him by section 18E(2)(b) is introduced by the words "in the case of a trade, profession or business which was commenced on or after 1 April 1974." I consider it impossible by any legitimate process of ratiocination to spell out of this, or out of anything elsewhere in the Ordinance, the conferment of a power on the Commissioner to do, in the case of a trade, etc. commenced *after* 1 April 1974, exactly the same thing as he is expressly authorised to do in the case of a trade, etc. commenced *before* 1 April 1974. Whatever the legislative history, and whatever powers the Commissioner had, or thought he had, before the enactment of section 18E(2)(b), I am not prepared to treat the words of section 18E(2)(b) as if they had read simply "in the case of any trade [etc]" (the words in fact used in section 18E(2)(a)) or as if, at the end of section 18E(2)(b), there had been added the words "just as he can already do in the case of a trade [etc] commenced before 1 April 1974." If anything *is* to be read into section 18E(2)(b), it seems to me that it should be the word "only" : "in the case *only* of a trade [etc] commenced after 1 April 1974." I agree with Rogers, JA that if the Commissioner had always had the power to do what he now seeks to do in relation to a trade [etc] commenced before 1 April 1974, section 18E(2)(b) would have been otiose.

Section 61A

I am of the opinion that, in changing its accounting date, the taxpayer performed an "operation" capable of being caught by section 61A and in fact caught, because it conferred on the taxpayer a tax benefit that, but for section 61A, would have been achieved by that operation. Having regard to that fact and to the fact that the taxpayer was at the time enjoying substantial profits (there are no other relevant facts) it must, in my opinion, be concluded that the taxpayer changed its accounting date for the purpose of enabling it to achieve such a benefit.

This is not, in my judgment, a case in which we are concerned only with the result in relation to the operation of the Ordinance that, but for section 61A, would have been achieved by the operation; we are concerned also with its timing, and I agree that this goes to the manner (and, I think, the substance) of the operation.

Conclusion

I agree with Rogers, JA, for the reasons he gives, that the application of section 61A is not precluded in this case by the provisions of section 18E. The result in the end is that the taxpayer succeeds on the section 18E point but fails on the section 61A point; so the appeal must be dismissed, with the consequence as to costs indicated in the conclusion to the judgment of Rogers, JA.

(Gerald Godfrey) Justice of Appeal	(Anthony Rogers) Justice of Appeal	(K.H. Woo) Judge of the Court of First Instance

Mr Michael Flesch, QC & Mr. Ramesh Sujanani instructed by M/S Ford, Kwan & Co for Appellant

Mr Mark Herbert, QC instructed by Department of Justice for Respondent