CACV 343 /2005

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

CIVIL APPEAL NO. 343 OF 2005
(ON APPEAL FROM HCIA NO. 8 OF 2004)

BETWEEN

COMMISSIONER OF INLAND REVENUE Appellant

and

TAI HING COTTON MILL (DEVELOPMENT) LIMITED Respondent

Before: Hon Rogers, Tang VPP and Le Pichon JA in Court
Date of Hearing: 7-9 November 2006
Date of Handing Down Judgment: 22 December 2006

J U D G M E N T

Hon Rogers VP:

1. This is an appeal from a judgment of Deputy High Court Judge Poon given on 9 September 2005. The matter before the judge was an appeal by way of case stated dated

9 December 2004 in respect of the decision of the Board of Review. At the conclusion of the hearing of this appeal judgment was reserved which we now give.

Background

2. The taxpayer, Tai Hing Cotton Mill (Development) Ltd, is a wholly-owned subsidiary of Tai Hing Cotton Mill Ltd which will be referred to in this judgment as the parent company. The parent company' s business lay in the production of cotton. It had a cotton mill on what has been referred to as Site I. It had quarters and other buildings on what have been referred to as Sites II and III. It no longer wished to retain all the land but wished to have a new mill on Site III and to have Site II redeveloped together with Site I, once that Site had been cleared. To this end the parent company and the taxpayer entered negotiations with Hang Lung Development Company Ltd ("Hang Lung") as to how that would take place. As summarised in paragraphs 11-13 of the case stated there were three agreements which were entered on 18 December 1987. These were as follows:

a) The Site I and Site II agreement. This was a sale and purchase agreement between the taxpayer and the parent company for the purchase of Sites I and II. The consideration for the sale of the land was identified in clause 2 as being:

   i) payment of $346,309,452.06 and interest thereon;

   ii) an obligation on the part of the taxpayer to build or procure the building of a new industrial building on Site III with construction costs of approximately $193 million;

   iii) a further sum of $400 million which was to be subject to the taxpayer realising net profits of that amount together with an additional sum equal to 50% of any such profits realised by the taxpayer from the development of the properties. This aspect was termed "the Balance Consideration". The Balance Consideration was to be paid only after finalisation of the audited development accounts.

b) There was then an agreement for the sale and purchase of Site III to another subsidiary of the parent company. That agreement apparently reserved the right to redevelop the land and committed the parent company to the obligation to build or procure the building of a new industrial building to be built on the Site.

c) The third agreement made on that day was between the taxpayer, Hang Lung and a subsidiary of Hang Lung which had been formed for the purpose of the development of the three Sites namely Stanman Properties Ltd ("Stanman"). This agreement was a joint venture agreement. Under this agreement Hang Lung

> agreed in principle with the taxpayer to procure the redevelopment and construction on Sites I and II of commercial and residential complexes to be known as Tai Hing Gardens and for the construction on Site III of the replacement industrial building. The industrial building was to be provided at no cost to the taxpayer. Stanman was to be the developer and would finance the costs, expenses and charges in carrying out and completing the development of the three Sites. The sales proceeds to be derived from the development would be applied first to reimburse the taxpayer and Stanman of the costs of the development and the balance would be shared between those two parties.

3. Over the course of the next 10 years or so the development of the Sites proceeded. The taxpayer paid the parent company various sums at various times in accordance with the provisions of the Site I and Site II agreement. In short there was an initial sum of $196,309,452 which had been paid in the period leading up to 18 December 1987. The remaining $150 million which formed part of the consideration referred to in 2 a) (i) above was not paid until February 1991. Over a period between September 1994 and November 1995 various payments were made which totalled $400 million. Then in March 1996, 1997 and 1998 3 payments were made which totalled $337,775,000.

The determination by the Commissioner

4. In his determination the Commissioner approached the matter on the basis that the market value for Sites I and II as at 18 December 1987 had been a total of $800 million. Taking that into account and based on the fact that the audited accounts of the taxpayer ended 31 March 1989 had shown the land cost at $746,309,452 he said:

> "In reality, I consider that the payments which exceed the market value of the two sites were not payments for the land but appropriation of the profits to THCML [*the parent company*] which the [*taxpayer*] derived from the development of the Tai Hing Garden. Therefore such payments made to [*the parent company*] being in the nature of appropriation of profits were not deductible under section 16 of the IRO."

5. The determination then turned to section 61A of the Inland Revenue Ordinance ("the Ordinance"). In that respect it concluded that the purchase of the land by the taxpayer from the parent company on the terms which had been set out in the Site I and Site II agreement was a transaction which fell within the scope of section 61A namely that the sole or dominant purpose had been that of enabling the taxpayer either alone or in conjunction with others to obtain a tax benefit. The determination set out the various subsections of section 61A(1) and in doing so the Commissioner referred to the consideration as being "commercially unrealistic and grossly excessive", the claim to deduction of the cost paid by the taxpayer as being "excessive payments for the sites" and the "purported sale of the land by THCML at an exorbitant price". I would simply add that as far as this case is concerned there appears to have been no further reference to the sale

of the land being "purported" and no further argument or suggestion to that effect has been advanced.

The Board of Review decision

6. Crucially important in the decision of the Board was the finding of fact that the consideration under the Site I and Site II agreement was "not excessive and was realistic from a business or commercial point of view". The Board was well aware that there was agreement between the parties that the market value of the Sites as at 18 December 1987 had been $800 million. There were reasons why the Board was prepared to reach the conclusion that the consideration payable under the Site I and Site II agreement was not excessive and was realistic from business and commercial point of view.

7. One of the reasons referred to by the Board was the fact that in respect of the bulk of the consideration payable under clause 2 of the Site I and Site II agreement, namely, the Balance Consideration, no interest was payable at least until 60 days after finalisation of the audited development accounts.

8. Consideration also has to be given as to the circumstances that existed both in Hong Kong and elsewhere in 1987. There had been a state of flux since the early 1980s when the future of Hong Kong was under consideration. Thereafter, no doubt, there had been an appreciation in the value of land but it is a well-known fact that in October 1987 there had been a somewhat eratic fluctuation in stock market prices in many countries which has been referred to commonly as "Black Monday". Whatever price might have been obtained for the Sites on the open market did not necessarily reflect the value of the Sites in the eyes of the management of the parent company. Clearly, the parent company intended not only to continue business but to do so in entirely new premises. There is no indication that the parent company would have been a willing seller at the open market price.

9. In relation to section 16 of the Ordinance the Board observed that no reference to section 16 had been made in the written submissions on behalf of the Commissioner. The simple finding by the Board was that once it had been decided that the consideration under the Site I and Site II agreement was not excessive and was realistic from a business or commercial point of view, section 16 could not assist the Commissioner.

10. In relation to section 61A the Board was careful to consider what was the impugned transaction. On the basis that it was the Site I and Site II agreement, the Board considered that no profit arose therefrom and in the absence of profit there was no question of a tax benefit. The Board went on to refer to the fact that it was the Site I and Site II agreement which gave the taxpayer the interest in the land without which it could not have entered the joint venture agreement with Hang Lung and Stanman and that it was the joint venture agreement which enabled the taxpayer to earn the profit which is the subject of this case. The Board had considered the effect of

the Site I and Site II agreement in the context in which it had occurred, namely, the context of the two other agreements which were entered into on 18 December 1987 together with the background of the parent and taxpayer and set out their findings in paragraph 61, 62 and 63 of the case stated. In paragraph 92 it was said that:

> "The Board's overall conclusion was that the sale or dominant purpose was not the obtaining of a tax benefit. Any possible purpose of obtaining a tax benefit palled in significance to the purposes referred to in paragraphs 61, 62 and 63 above."

11. It was in those circumstances that the Board remitted the various assessments made to the Commissioner to revise them on the basis that the Commissioner should not have charged the taxpayer as having made a profit in respect of the amount which had been deducted as having been paid to the parent company in excess of $800 million. The Board was then asked to state a case. The questions of law in the case stated were as follows:

> "Section 61A
>
> 1. (1) Whether the Board erred in law in failing to hold that "the transaction" (as defined in section 61A) impugned, namely, the Site I and Site II agreement, did or would have the effect of conferring a tax benefit on the Taxpayer;
>
> (2) whether the Board erred in law in its holding that the *"the impugned transaction did not have, and would not have had but for section 61A, the effect of conferring a tax benefit … on the appellant"* (paragraph 74 of the Decision). Hence, whether the Board further erred in its conclusion that *"section 61A is not relevant"* (paragraph 74 of the Decision);
>
> (3) whether the Board erred in law in holding that *"there was no question of a tax benefit"* (paragraph 75 of the Decision); and whether the Board erred in its holding by taking the view that "*no profit accrued to the appellant under the Site I and Site II agreement"* (paragraph 75 of the Decision).
>
> 2. Whether the Board erred in law in treating as relevant the matters set out in paragraph 76 of the Decision.
>
> 3. If, contrary to the Board's decision, the Site I and Site II agreement did or would have the effect of conferring a tax benefit on the Taxpayer, whether the Board erred in failing to come to the true and only reasonable conclusion that the sole or dominant purpose of entering into the Site I and Site II agreement

was indeed for that relevant purpose, namely, to enable the Taxpayer to obtain a "tax benefit" as defined in section 61(3).

4. In holding that "the sole or dominant purpose" of entering into the Site I and Site II agreement was not that provided for under section 61A (paragraph 92 of the Decision), whether the Board erred in treating as relevant the following matters:

   (1) *"the consideration under clause 2 of the Site I and Site II agreement was not excessive and was realistic from a business or commercial point of view"* (paragraph 85 of the Decision);

   (2) *"neither the appellant nor the parent company knew whether the redevelopment would be profitable"* (paragraph 85 of the Decision);

   (3) *"the effect of interest on the deferred payment of the balance consideration"* (paragraph 85 of the Decision).

Section 16

5. Whether the Board erred in law in failing to hold that the payments ultimately made to the parent company under the Site I and Site II agreement, insofar as they exceeded the agreed open market value (HK$800 million) of Site I and Site II on 18 December 1987 ("the excess"), was not an outgoing or expense within the meaning of section 16.

6. In respect of the disallowance of the excess by the Commissioner or her assessors by reason that it was not an outgoing or expense within the meaning of section 16, whether the Board erred in taking the view that such disallowance was an act by the Commissioner or her assessors *"to reduce the amount of consideration to what [the Commissioner] considers to be reasonable"* (paragraph 97 of the Decision). Hence, whether the Board consequently also erred in its conclusion by taking the view that *"section 16 confers no authority"* on the Commissioner or her assessors to do so (paragraph 97 of the Decision)."

The judgment in the court below

12. The judge answered all the questions in the case stated in the affirmative and accordingly allowed the appeal by the Commissioner. In doing so, although the judge cited at length from the judgment of Bokhary PJ in *Kwong Miles Service Limited v CIR* [2004]

3 HKLRD 168 in relation to the approach by the court when there is an appeal on law, he felt able to overrule the Board of Review's findings of fact.

13. When dealing with section 16 the judge started with the proposition that the main issue was whether the Balance Consideration had been incurred in the production of profits of the taxpayer. He referred to a number of decided cases and was clearly troubled by the fact that the Balance Consideration was referable to profits which had been made. In paragraph 108 of the judgment he referred to the necessity of giving section 16 a purposive construction and have a realistic analysis and objective assessment of the facts. This he went on to construe as requiring the matter to be looked at on the basis that the redevelopment of the Sites was a joint venture between the Tai Hing Group on the one hand and the Hang Lung Group on the other for mutual profits. Having done that he then said:

> "The redevelopment did not in any way depend on the manner in which the Parent Company and the Taxpayer structured the land cost between them. It is not a "payment necessary for the purpose of enabling the company or the trader to earn the profits of its trade" : see *British Sugar*, per Romer LJ at p.239. Further, whether the Balance Consideration was eventually paid to the Parent Company would have made no difference to the whole redevelopment, which is the Taxpayer's source for earning the profits, or the profits derived therefrom. It is clearly not for the purpose of producing profits. It is either a sharing of profits *simpliciter* or, put at its highest, a payment by the Taxpayer to acquire a right or opportunity to earn profits. In either case, it is not deductible."

14. The judge accepted the argument on behalf of the Commissioner that the Balance Consideration in clause 2 of the Site I and Site II agreement had the effect that the proceeds represented by it were derived by the taxpayer from the development of the property and would not attract liability to profits tax. This constituted reducing the amount of tax and therefore was a tax benefit. In paragraph 51 of the judgment the judge downgraded the Board's finding of fact that the consideration under the Site I and Site II agreement was not excessive and was realistic from a business or commercial point of view to a mere "observation". Having done that he said that it was not relevant as to the question whether entering into the agreement had or would have the effect of a reduction in the amount of tax by the taxpayer. He then went on to say "when Clause 2 thereof is properly understood (as described in paragraph 40 above), it must have such effect when part of the proceeds of the redevelopment were converted into a purported item of expenditure".

15. In paragraph 71 of the judgment the judge referred to three points made on behalf of the Commissioner, namely, that the taxpayer had not commenced business until October 1987, that there had been no formal valuation of the Sites and no evidence of any feasibility study of the project to be undertaken or the commercial risks involved and, lastly, that the taxpayer's capital was only $10,000 and yet the parent company was still willing to pay sell the land for a very high price.

This appeal

16. On this appeal, Mr Flesch QC, who appeared on behalf of the taxpayer, submitted that the judge had not been entitled to ignore the findings of fact made by the Board and to substitute his own findings which were "clearly and demonstrably" in error. Mr Goldberg QC, who appeared on behalf of the Commissioner, for his part did not seek to support the reasons given by the Commissioner for his determination and similarly made absolutely no reference to the judgment in the court below. Rather he sought to argue the matter virtually as if it were an appeal from the Board of Review directly.

Section 16

17. Although the judge below, and indeed Mr Flesch in this court, dealt with the question of section 61A before dealing with section 16, it appears to me that it is more appropriate to consider first the application of the provisions of section 16 to the facts of this case. The relevant provisions of that very lengthy section as regards this case may be condensed down to the requirement that the taxpayer is entitled to deduct "outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax…"

18. As already indicated, the Board's approach was simple. From a business and commercial point of view the consideration paid by the taxpayer to the parent company under clause 2 in respect of its obligations of the Site I and Site II agreement were not excessive and were realistic. In other words the consideration paid by the taxpayer and sought to be deducted as a legitimate expense was a perfectly proper amount. If that be right then, for my part, I can see no legitimate reason for denying the taxpayer the ability to take that amount into account when ascertaining its profits.

19. Mr Goldberg sought to deflect this finding of fact with which he was faced on the basis that what the court must consider is a matter of quality and not quantity. In part this argument depended on the proposition that the Balance Consideration was a portion of the profits. That may be so, but it is clear that that is not a fundamental objection. The matter of payments based on a percentage of profits has arisen in a number of cases. The decision of the Court of Appeal, Sir Wilfred Greene MR, Romer LJ and McKennan LJ in *British Sugar Manufacturers Limited v Harris (HM Inspector of Taxes)* (1937) 21 TC 528 was in my view probably of the most assistance. In an illuminating judgment Sir Wilfred Greene MR drew the distinction between payments of "profits", in that case for services to be rendered, but in other cases perhaps for physical goods or other matters which might be regarded as stock-in-trade, and payments which simply represented the share of the profits which had been purchased by some contract whether it be a franchise or otherwise. Romer LJ said at page 549 that the question could be stated thus: "is the payment that has to be made by the trader under the contract which is in question in truth a mere

division of profits with another party or is it in truth the payment to the other party, the amount of which is ascertained by reference to the profits?"

20. In this case the Commissioner approached his determination on the basis that the consideration paid by the taxpayer was excessive and exorbitant. On that basis it was quite right to disregard the terms of the contract and consider them merely a disguise for an illegitimate transfer of profits. But once it is established that the price paid is a proper price, and in my view there is no basis for upsetting that finding of fact, there is no ground for disallowing the amount paid to be taken into consideration in the calculation of the profits.

21. Indeed it might be observed that even the Commissioner in his determination was prepared to allow that part of the consideration which had been arrived at by calculating a percentage of the profits of, namely, the difference between $800 million which was taken as the market value and the $746,309,452.06, which had been paid in the period up until November 1995, as allowable. At a glance it might be said that this mere $50+ million was irrelevant. Further consideration, however, must undoubtedly give rise to the conclusion that it was a substantial amount. What, in effect, the Commissioner sought to do was to rewrite the Site I and Site II agreement substituting the consideration with a new consideration.

22. In fairness to Mr Goldberg, however, it has to be stated that he argued the point with less than enthusiasm and, in the end, indicated that the Commissioner was concerned that guidance should be given as to how the matter should be considered.

23. The judge's approach to the issues on section 16 which centred on what he considered was a purposive construction were in my view wrong. It was not legitimate to regard the matter as simply a joint-venture between two groups of companies. Whatever companies comprised those groups were simply not defined. In paragraphs 60, 61 and 62 of the case stated the Board had set out the commercial reality of the situation. What the judge purported to do went far beyond giving a purposive construction to section 16 but was tantamount to applying the *Ramsay* doctrine in circumstances where there was no justification to do so. It remains only to be said that questions 5 and 6 of the case stated should have been answered in the negative.

24. Section 61A is an anti-avoidance provision which applies where a transaction has been entered into which has, or would have had but for the section, the effect of conferring a tax benefit on a person. It requires the taking into consideration of a number of specified matters for the purpose of determining whether it would be concluded that the taxpayer 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. Tax benefit is defined in subsection (3) as meaning "the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof."

25. The first matter to be considered is what was the transaction. In this respect there was no difference between the parties, who approached the matter on the basis that the transaction is the Site I and Site II agreement. Having established that, the next consideration is whether there has been a tax benefit. That latter matter is the subject of the first question in the case stated. Mr Goldberg sought to argue that any deduction from profits whether it be a legitimate business expense or otherwise would constitute a tax benefit. In my view, that argument as applied to the facts of this case is unsustainable. Put quite simply when income is generated in a business as a result of the use of stock-in-trade, the capital acquisition cost of that stock-in-trade is a business expense. If the capital acquisition cost of that stock-in-trade was not excessive and realistic from a business and commercial point of view it falls to be taken into account in ascertaining profits. If in those circumstances there can be no objection to the capital acquisition cost of stock-in-trade being taken into account in ascertaining profits arising out of the use that stock-in-trade, to construe the words tax benefit as including that capital acquisition cost when the only use and effect of that cost for fiscal purposes has been, in accordance with section 16, for the purposes of ascertaining profits arising from the use of the relevant stock-in-trade, is not to construe the Ordinance but to abuse the language of the statute as Cross J, as he then was, said in *Commissioner of Inland Revenue v Kleinwort, Benson Ltd* (1968) 45 Tax Cases 381 at page 382 F-G.

26. As part of his submission in this court Mr Goldberg sought to emphasise that the whole arrangement arrived at by the parent company, the taxpayer, Hang Lung and Stanman constituted blatant tax evasion. This form of jury point was sought to be bolstered by the notion that starting with the case of the *Commissioner of Inland Revenue v Burmah Oil Co. Ltd* (1981) 54 TC 200, particularly at page 214 D-E, there had been a significant change in the approach adopted by courts in relation to schemes which the courts might consider were tax evasion. It was said that this new approach had been adopted in many jurisdictions. In my view, whatever the application or effect of the *Ramsay* doctrine with which Lord Diplock was concerned at the time, the fact remains that words in legislation must be given their proper meaning. It has long been the case that interpretation of tax legislation has been regarded as being neutral: there should be no attempt to favour either the Revenue or the taxpayer. It is not the function of the Court to strain a construction of tax legislation to try to close any perceived deficiencies on behalf of the Revenue. When section 61A speaks of tax benefit it is not speaking of the capital acquisition cost of stock-in-trade which is the basis of the income generated as a result of its use, unless it can be said that that capital cost has been inflated or is otherwise not genuine, in which case it would probably not be deductible as an outgoing or expense in ascertaining profits in accordance with section 16.

27. The Board' s approach in paragraph 76 of the case stated is referable to the argument advanced. The taxpayer, supported by the finding of fact by the Board, contends that the consideration under clause 2 of the Site I and Site II agreement was a proper price to pay for the stock-in-trade, namely the land. The argument advanced both below and in this court on behalf of the Commissioner was that it was a tax benefit. The Board found it was a payment without which the profits in question could never have arisen by reason of the fact that without the benefit of the Site I and Site II agreement the taxpayer could not have entered into the joint venture with Hang

Lung and Stanman and if that had not happened there would have been no development and hence no profit.

28. If it were necessary, the analysis might be taken further. Although, as Mr Goldberg was at pains to emphasise, under section 14 profits tax is charged on every person carrying on a trade, profession or business in Hong Kong, it is only in respect of his assessable profits arising in or derived from Hong Kong from such trade that profits tax becomes payable. Hence if there is no profit there is no tax under section 14. As already pointed out, in accordance with section 16, legitimate outgoings and expenses are the subject of deductions in ascertaining profits. Hence the situation of a liability to profits tax does not arise until after profits have been ascertained by taking into account outgoings and expenses.

29. Reference was made to the statement made by Lord Diplock in *Europa Oil v IRC* [1976] 1 WLR 464 at 475C-D where he said in construing a similar but not identically worded provision in New Zealand tax legislation:

> "Secondly, the description of the contracts, agreements and arrangements which are liable to avoidance presupposes the continued receipt by the taxpayer of income from an existing source in respect of which his liability to pay tax would be altered or relieved if legal effect were given to the contract, agreement or arrangement sought to be avoided as against the commissioner. The section does not strike at new sources of income or restrict the right of the taxpayer to arrange his affairs in relation to income from a new source in such a way as to attract the least possible liability to tax. Nor does it prevent the taxpayer from parting with a source of income."

30. He was there analysing the logic of the relevant provision in the context of a situation where the Revenue was arguing that a profit arrived at as a result of a dividend paid by a company outside the jurisdiction should be treated as profit for the purpose of computation of the New Zealand tax. Hence, although it is perfectly true as Woo JA, as he then was, said in *Cheung Wah Keung v CIR* [2002] 3 HKLRD 773 paragraph 48, p.791D-E :

> "…' pre-existing' liability to tax or circumstances do not appear in s.61A(3) or anywhere else in the Ordinance having any bearing on the meaning of the ' transaction' referred to in that section."

that is a statement that the words in issue do not appear in the legislation; it looks at the matter from a strictly verbal point of view but does not address the conceptual point which is derived from the reasoned analysis of the effect of all the provisions of the legislation, such as was undertaken by Lord Diplock.

31. Our attention was also drawn to the Australian Federal Court decision of *Bunting v Federal* Commissioner *of Taxation* 90 A.L.R. 427 where at page 437 Gummow J said:

> "The concept of ' source' is one which is of great importance to the operation of s 25 of the Act, but it is there used as a geographical discrimen. For myself, I find it difficult to see how what was said by Lord Diplock (when dealing with the New Zealand legislation) derives support from the terms of s 260. That provision, on its face, applies to each year of income (there are four years involved in this case) and asks in respect of each year whether there has been a contract, agreement or arrangement, made or entered into (one should note) at any time, which has the purpose or effect described. There is, on the face of the section, no necessity for there to be any derivation of income at all before the arrangement is made or entered into. The question will be whether in respect of the given year of income the arrangement has the purpose or effect which attracts the ' annihilating' operation of the section."

32. It is, perhaps, unnecessary for the purpose of this case to decide the question as to whether section 61A is predicated on the existence of an existing source of income. To do so may risk overlooking some unforeseen circumstances.

33. I would put the matter thus: tax benefit as defined in section 61A(3) is predicated on a liability to tax. If the liability in question has arisen because of the generation of income from the employment of stock-in-trade, the capital acquisition cost of that stock-in-trade is the root of the income. When properly considered it is the cause of the income and hence the root of the particular profits and hence also of the liability to tax. It cannot therefore be said that the incurring of the capital acquisition cost is an avoidance of a liability to tax when it is the root cause of it.

34. It might be possible that other sources of income might arise after the creation of the arrangement which is said to give rise to the tax benefit. If that be the case, the same reasoning would not apply to that arrangement because the particular costs would not be the root of, and hence an integral part of, the income and profit. Again there are many costs which are deductible as outgoings or expenses under section 16(1), for example research and development costs, depreciation costs and financing costs to name but a few, and these too, because they are not the foundation of and thus an integral part of the generation of the income could possibly fall within the meaning of tax benefit.

35. Whilst, for my part, I consider that Lord Diplock' s logical analysis of section 108, which he was considering, is correct and that Gummow J' s analysis does not, in fact, address the point made by Lord Diplock, I am content to confine myself to what is necessary for the decision in this case.

36. What is, perhaps, of more interest is the statement made by Lord Diplock at page 475H-476B of the *Europa Oil* case:

> "Their Lordships' finding that the moneys paid by the taxpayer company to Europa Refining are deductible under s 111 as being the actual price paid by the taxpayer company for its stock-in-trade under contracts for the sale of goods entered into with Europa Refining, is incompatible with those contracts being liable to avoidance under section 108. In order to carry on its business of marketing refined petroleum products in New Zealand the taxpayer company had to purchase feedstocks from someone. In respect of these contracts the case is on all fours with *Cecil Bros Pty Ltd v Federal Comr of Taxation* (1964) 111 C.L.R. 430 in which it was said by the High Court of Australia at 434: ' it is not for the court or the commissioner to say how much a taxpayer ought to spend in obtaining his income' ; …"

37. In short Lord Diplock' s approach was the same as that in paragraph 25 above. The point may be put in another way: there can be no tax benefit without a liability to pay tax; there can be no tax unless there have been profits generated; if the profits arose from a specific transaction and had been ascertained having taken into account outgoings and expenses incurred as the capital cost of the initial and indispensable step in generating the particular profits, those outgoings and expenses cannot then be treated as a tax benefit in relation to the transaction in question. Whilst, of course, the legislation could have been framed such that any outgoing or expense would fall within the purview of section 61A, I do not consider that has been done. Such a course may have been adopted in tax avoidance provisions in legislation in other countries, but a comparison of such legislation does not, in my view, assist.

38. I appreciate that it was argued that a "purposive" construction of "tax benefit" would encompass the capital cost of stock-in-trade to be on sold, as in the *Kleinwort, Benson* case. However, I associate myself with what Cross J said that it was a very tendentious argument. In other words it is not a purposive construction in the sense used in other judgments, it is a construction with an underlying purpose of promoting a particular point of view. As already stated it is not the function of the courts to remedy perceived deficiencies in tax legislation. In my view Cross J did not decide that the argument was correct, he simply pointed out that it was fruitless because taken to its logical conclusion as part of the section it led to a ridiculous result.

39. On that basis section 61A has no application because there was no tax benefit. But even if it were right to consider that the Balance Consideration, or at least part of it, was a tax benefit, I do not consider that it was open to the judge below to interfere with the finding by the Board that the sole and dominant purpose was not the obtaining of a tax benefit. In the light of the matters taken into consideration by the Board, in particular the matters referred to in paragraphs 60, 61, 62 and 63 of the case stated, there were clearly sound commercial reasons for the parties to enter into the various agreements including the Site I and Site II agreement. None of the matters referred to in paragraph 71 of the judgment whether taken separately or together would lead to the conclusion that the Board had reached an erroneous conclusion, still less one that would justify the court in disregarding it and substituting its own findings of fact.

40. One of the matters which the judge considered irrelevant and as "distracting" as it was wrong was the question of interest that might otherwise have been paid on the Balance Consideration. The Site I and Site II agreement provided that the consideration for payment of the land would be deferred for a considerable period of time. Obviously in December 1987 no one would have known exactly how much interest might have been paid even on the deferred $400 million. The fact is however, that if the parent company had chosen to sell the Sites on the open market it would have received a cash payment then and there of $800 million. By being kept out of the Balance Consideration for many years it lost opportunity cost on working capital or, at the very minimum, substantial amounts of interest.

41. In my view all the questions in the case stated should have been answered in the negative and therefore this appeal must be allowed and the assessments on the taxpayer for the years 1995/96, 1996/97 and 1997/98 be remitted to the Commissioner for revision to give effect to the Decision of the Board dated 29 March 2004. I would make an order *nisi* that the costs of this appeal and in the court below be to the taxpayer to be taxed if not agreed.

Hon Tang VP:

42. This appeal concerns that part of the purchase price which was represented by 50% of any profits realized by the taxpayer from the development of the properties (the 50% profits). By the time of the assessments, the subject of the appeal, the amount paid in respect of this portion of the purchase price amounted to $290 million.

43. However, in principle, I do not believe this part of the purchase price is distinguishable from the other parts of the purchase price which included a payment of $346,309,452.06 and interest thereon, payable by instalments, as well as the further sum of $400 million which was to be subject to the taxpayer realizing net profits of that amount.

44. The revenue accepted that both $346,309,452.06 and $400 million were deductible for the section 16, and not caught by section 61A.

45. Although the further payment of $400 million was only payable out of the profits of the development, the Commissioner in his Determination, with commendable common sense, proceeded on the basis, since the open market value of the Site as at the relevant date was $800 million, the $400 million should be deductible as part of the purchase price. But he regarded the total price then paid of $1,090 million as exorbitant, and such that the additional $290 million paid enabled the taxpayer to siphon off that sum to its parent in the form of non-taxable capital gains. See page 22 of the Determination.

46. However, the Board came to the view that the consideration for the Sites which included the 50% profits "was not excessive and was realistic from a business and commercial point of view". See para. 96 of the case stated.

47. I agree with Rogers VP that this was a finding of fact which the Board was entitled to make and which the judge was not entitled to overturn.

48. For that reason I would also allow the appeal. However, I would say a few words about section 61A though it would have no impact on the outcome of the appeal. For that reason, I will deal with it briefly.

49. I am of the view that although the $290 million was part of the purchase price, and as such deductible under section 16, it might still be covered by the definition of tax benefit under section 61A.

50. Tax benefit is defined as "the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof;". In my opinion, 'tax benefit' as defined, can cover the deduction of the purchase price incurred for the purchase of assets used in the production of profits.

51. Section 16 is not a charging section. The charging section is section 14, under which profits tax shall be charged on:

> "… every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part."

52. 'Assessable profits' is defined in section 2 as "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;".

53. Section 16 permits deduction of "all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which is chargeable to tax under this Part for any period." However, the conditions of section 16(2) must also be satisfied. This means that an interest expense, deductible under normal accounting practice, may for the purpose of calculation of assessable profits under section 16 be disregarded. Thus, for tax purposes assessable profits may be different from actual accounting profits.

54. As Lord Millett explained in *Commissioner of Inland Revenue v Secan Limited and Anor* [2000] 3 HKCFAR 411 at 420:

> "Sections 16 and 17 (which disallows certain deductions) are enacted for the protection of the revenue, not the taxpayer, and in my opinion s.16 is to be read in a

> negative sense. It permits outgoings to be deducted only to the extent to which they are incurred in the relevant year."

55. Section 16 and section 61A have different functions. An outgoing or expense which is deductible under section 16 is covered by the definition of tax benefit under section 61A, since such an expense or outgoing would ordinarily have the effect of reducing the amount of the tax payable.

56. In *Peterson v CIR* [2005] STC 448, the Privy Council was concerned with section 99 of the Income Tax Act 1976 of New Zealand, a general anti-avoidance provision, which was described by Lord Millett, in the following terms:

> "[4] Section 99 is a general anti-avoidance provision which entitles the Commissioner to adjust a taxpayer's assessable income in order to counteract a tax advantage which he has obtained by a tax avoidance scheme. Their Lordships observe that reliance by the Commissioner on the section presupposes that he accepts that but for its provisions the scheme would have succeeded in achieving its object; for, if not, the taxpayer has not obtained a tax advantage and there is nothing for the Commissioner to counteract. As Richardson P said in *Comr of Inland Revenue v BNZ Investments Ltd* [2002] 1 NZLR 450 at [41]:
>
> '… it is inherent in the section that, but for its provisions, the impugned arrangements would meet all the specific requirements of the income tax legislation.'"

57. So the fact that the purchase price was deductible under section 16 for the calculation of assessable profits would not take it outside the definition of tax benefit under section 61A. Indeed if a deduction is not permissible under section 16, section 61A will not be needed. The fact that a deduction is allowable under section 16, not only would not preclude the application of section 61A, that would normally be the trigger.

58. Tax benefit has a defined meaning in section 61A. It can include deductions allowable under section 16. The relevant person would normally be the person who has taxable income, out of which, deductions could be made. However, section 61A does not require that the actual tax dollars saved, should remain with the relevant person. Thus, payment of interest on a bona fide loan could be a tax benefit as defined, although, the interest, once paid, would leave the relevant person. If all the requirements of section 61A are satisfied, the interest would normally be paid directly or indirectly to a person, within the group but out of the reach of the Revenue. In other words, the fact that for accounting purposes the interest expense has been incurred in the production of profits is not an answer to the application of section 61A. As noted, that fact alone does not ensure deductibility under section 16(1) since the conditions of section 16(2), which is also an anti

avoidance provision, must be satisfied. I believe tax benefit as defined in section 61A may include expenses which are otherwise deductible for normal accounting purposes. If it is correct that under section 61A, it does not matter that the "tax benefit" in the sense of money gained or saved does not remain with the relevant person, then in principle, I do not believe the definition of "tax benefit" in section 61A requires any distinction to be drawn being different types of deductions. In the case of the purchase price of an asset in the production of profits or interest paid in its acquisition, deductibility of interest paid under section 16(1) would depend on the conditions of section 16(2) being satisfied. In respect of both the purchase price and the interest, assuming the conditions of section 16(2) are satisfied, the application of section 61A would depend on its conditions being satisfied.

59. Indeed, Mr Goldberg submitted that every deduction for the purpose of the calculation of assessable profits is a tax benefit within the meaning of section 61A.

60. Some support for this view can be found in *Commissioners of Inland Revenue v Kleinwort, Benson Ltd* [1968] 45 TC 369, a decision of Cross J (as he then was).

61. There, the issue was whether the taxpayer had obtained a tax advantage in circumstances covered by section 28(2)(b) of the Finance Act 1960. If so, unless the taxpayer can show that "the transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments, and that none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained", the tax advantage would be counteracted.

62. The respondent, the well-known merchant bank, as a dealer in securities, purchased in 1962 certain mortgage redeemable debentures stock, on which no interests had been paid since 1939, but on which it was expected that full payment of the principal, premium and arrears of interest would shortly be made. There was tax advantage because as a dealer, the respondent was entitled to keep the interest element out of his tax return and so was able to pay a higher price than an ordinary taxpayer and still make a profit.

63. Section 43(4)(g) of the Finance Act 1960 defines ' tax advantage' as follows:

> "' tax advantage' means a relief or increased relief from, or repayment or increased repayment of, income tax, or the avoidance or reduction of an assessment to income tax or the avoidance of a possible assessment thereto, whether the avoidance or reduction is effected by receipts accruing in such a way that the recipient does not pay or bear tax on them, or by a deduction in computing profits or gains."

64. This is what Cross J said:

> "The Special Commissioners have held that it was one of the main objects of the Company in purchasing this stock to obtain the right to diminish its taxable profits by deducting the sum of £156,000 odd. Section 28 was, of course, aimed primarily at purely artificial transactions into which no one would have thought of entering apart from the wish to reap a 'tax advantage', but it is clear that the section is so framed as to cover *bona fide* commercial transactions which are combined with the securing of a tax advantage. … Here there was only a single indivisible transaction, and it was an ordinary commercial transaction, a simple purchase of debenture stock. As the purchaser was a dealer, he was entitled to keep the interest element out of his tax return and so was able to pay a higher price than an ordinary taxpayer would have been able to pay. Similarly, a charity, because it would have been able to reclaim the tax, would have been able to pay an equally large price and still make a profit. But it is to my mind an abuse of language to say that the object of a dealer or a charity in entering into such a transaction is to obtain a tax advantage. When a trader buys goods for £20 and sells them for £30, he intends to bring in the £20 as a deduction in computing his gross receipts for tax purposes. If you choose to describe his right to deduct the £20 (very tendentiously be it said) as a 'tax advantage', you may say that he intended from the first to secure this tax advantage. But it would be ridiculous to say that his object in entering into the transaction was to obtain this tax advantage. In the same way I do not think that you can fairly say that the object of a charity or a dealer in shares who buys a security with arrears of interest accruing on it is to obtain a tax advantage, simply because the charity or the dealer in calculating the price which they are prepared to pay proceed on the footing that they will have the right which the law gives them either to recover the tax or to exclude the interest, as the case may be. One may, of course, think that it is wrong that charities and dealers should be in this privileged position. But if the Crown thinks so it ought to deal with the matter by trying to persuade Parliament to insert provisions in a Finance Act depriving them of their privileges, not by seeking to achieve this result by a back door by invoking s. 28. So if I had thought that the case fell within s. 28(2)(b) I should have held that the gaining of a tax advantage was not the object or a main object of the transaction."

65. In my opinion, although one would not normally describe the payment of £20 for goods sold for £30 as a tax advantage or tax benefit, but it would nevertheless fall within the definition of tax benefit, when it is construed purposively. Of course, the fact that tax benefit is capable of such a wide reach would only matter, if the other conditions of section 61A are satisfied. It is difficult to conceive of a case where, in such circumstances, the sole or dominant purpose was to confer a tax benefit. However, I would not underestimate the ingenuity of tax professionals.

66. The other conditions are:

> "1) identification of the transaction by reference to which the section applies;

2) identification of the relevant person – in every case the taxpayer;

3) to ascertain whether the effect (not the purpose) of the transaction is to confer the tax benefit; and

4) to conclude whether, with reference, only to the seven matters mentioned in section 61A – all of which must be taken into account – one of the actors in the identified transaction has a sole or dominant purpose of enabling the taxpayer to obtain the tax benefit identified at (3)."

67. In this case, at para. 92 of the case stated, the Board said that having "… looked at the matter globally. The Board' s overall conclusion was that the sole or dominant purpose was not the obtaining of a tax benefit." Therefore, since this vital element in section 61A was not satisfied, the appeal must be allowed. This is question of fact and is a matter for the Board, upon a consideration of all the relevant evidence and the proper inferences to be drawn from that evidence. Unless, the decision could be said to be perverse, otherwise whichever way the Board decided it, a higher court could not properly say that they were wrong. Since the Board has held that the price was not excessive and was realistic from a business and commercial point of view, there is no basis upon which I can conclude that the decision of the Board, that the sole or main purpose of the purchase was not to confer a tax benefit, could be overturned.

Hon Le Pichon JA

68. I have had the advantage of reading in draft the judgments of Rogers and Tang VPP and agree that the appeal should be allowed. I gratefully adopt the facts set out in paragraphs 1 to 15 of the judgment of Rogers VP and agree fully with his analysis and reasoning in paragraphs 16 to 23 on the application of section 16 to the facts of the present case. This judgment is confined to a consideration of section 61A only.

Section 61A

69. Section 61A is an anti-avoidance provision adopted in 1986. For the section to apply at all, there has to be (1) a transaction; and (2) the transaction has to have the effect of conferring a tax benefit on the taxpayer (referred to as "the relevant person"). It is only if those conditions are satisfied that one would proceed to the next stage to see if one would conclude, by having regard to the seven matters set out in paragraphs (a) to (g) of subsection (1), that the sole or dominant purpose of one or more of the persons who had entered into or carried out the transaction was to enable the relevant person to obtain a tax benefit.

70. It is common ground that the transaction in the present case is the entering into of the Site I and Site II agreement. In view of the conclusion reached that the consideration paid by the taxpayer is an expense within section 16 of the Ordinance, the questions which arise are whether an

expense that is allowable under section 16 is capable of being a tax benefit for the purposes of section 61A and, if so, whether in this case there was a tax benefit.

Tax benefit

71. "Tax benefit" is defined in subsection (3) as meaning "the avoidance postponement of the liability to pay tax or the reduction in the amount thereof". Subsection (3) therefore contemplates three respects in which a tax benefit could be achieved, namely, by "avoidance", "postponement" and "reduction". I would observe that it matters not whether "reduction" is referable to the amount of tax or to the liability to pay tax as to which there had been some debate.

72. Section 14 of Part IV imposes a charge for profits tax on "assessable profits" arising in or derived from Hong Kong for that year from the relevant trade, profession or business "as ascertained in accordance with [Part IV]". "Assessable profits" means those profits that are chargeable to tax under Part IV. Section 16(1) provides for the deduction of outgoings and expenses to the extent to which they are incurred during the relevant period in the production of profits in respect of which the taxpayer is chargeable to tax under Part IV. Under the statutory framework, deductions form part of the process of ascertaining chargeable profits. In the absence of chargeable profits being generated, no liability for profits tax could arise. Assessable profits are therefore arrived at, as it were, post-deductions allowable under section 16.

73. Mr Flesch QC submitted that as a matter of plain language a deduction that is part of the process for computing chargeable profits cannot be or constitute a reduction of a liability so as to be a tax benefit within section 61A(3). It was also said that "liability" in subsection (3) must mean an existing or accrued liability to tax or, alternatively, there must be pre-existing circumstances which might have been expected to give rise to a liability to tax in the absence of the impugned transaction.

74. In the context of the avoidance of the liability to pay tax, "liability" is not confined to an existing or accrued liability. In *Newton v Commissioner of Taxation of the Commonwealth of Australia* [1958] AC 450, the Privy Council had to consider the meaning of the words "avoiding" a "liability imposed" in the Australian anti-avoidance legislation (section 260 of the Income Tax Assessment Act). It rejected the appellants' argument that in order that an arrangement should be avoided, it must be one which sought to displace a liability which had already come home to a taxpayer - in respect of income which had already been derived by him. As Lord Denning explained (at page 464),

> "… the word "avoid" was used in its ordinary sense ----- in the sense in which a person is said to avoid something which is about to happen to him. He takes steps to get out of the way of it …To "avoid a liability imposed" on you means to take steps to get out of the reach of a liability which is about to fall on you. If the submission of [the appellants] were accepted, it would deprive the words of any effect: for no one can

> displace a liability to tax which has already accrued due, or in respect of income which has already been derived."

I would respectfully agree. It would follow on Lord Denning's analysis that "liability" would encompass a potential liability to tax.

75. A person who carries on a trade is potentially liable to be taxed on all of his profits. Although his liability to tax would depend on the amount of his assessable profits and that in turn would depend on whether the amount of deductions allowable under section 16 exceeds receipts, as a matter of practical reality, that person does have a potential tax liability. In my view, allowable deductions could be said to have the effect of reducing that potential liability.

76. The 'pre-existing circumstances' submission appears to have been based on Lord Diplock's observations in *Europa Oil (N.Z.) Ltd v Inland Revenue Commissioner* [1976] 1 WLR 464 where he referred to the need for a pre-existing source of income. That case concerned, *inter alia*, section 108 of the Land and Income Tax Act 1954 which was the New Zealand anti-avoidance provision:

> "… Every contract, agreement, or arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void as against the Commissioner for income tax purposes in so far as, directly or indirectly, it has or purports to have the purpose or effect of in any way altering the incidence of income tax, or relieving any person from his liability to pay income tax."

In delivering the majority judgment Lord Diplock stated (at page 475C-D) that:

> "There must be some identifiable income of the taxpayer which would have been liable to be taxed if none of the contracts, agreements or arrangements avoided by the section had been made.
>
> Secondly, the description of the contracts, agreements and arrangements which are liable to avoidance presupposes the continued receipt by the taxpayer of income from an existing source in respect of which his liability to pay tax would be altered or relieved if legal effect were given to the contract, agreement or arrangement sought to be avoided as against the commissioner. The section does not strike at new sources of income or restrict the right of the taxpayer to arrange his affairs in relation to income from a new source in such a way as to attract the least possible liability to tax."

77. Reference has already been made in paragraph 31 of the judgment of Rogers VP to the decision of Gummow J of the Federal Court of Australia in *Bunting v Federal Commission of Taxation* [1989] 90 ALR 427. The passage quoted in paragraph 31 shows that Gummow J considered that what was said by Lord Diplock regarding the need for a pre-existing source whilst

applicable to the New Zealand anti-avoidance provision was not applicable to the Australian anti-avoidance provision. For my part, given my view that 'liability' includes a potential liability to tax, I do not consider that there has to be a pre-existing source of income before section 61A can apply.

78. *Europa Oil* is also relevant to what, as a shorthand reference, may be called the incompatibility issue. In that case, Lord Diplock stated that a finding that an expense is deductible being the actual price paid by the taxpayer for its stock-in-trade under a contract is incompatible with that contract being liable to avoidance under section 108. That was the majority view. Lord Wilberforce who dissented on the issue of deductibility, holding that the deduction was not allowable under section 111, expressed no view on section 108 since, on his view of the case on deductibility, it did not arise for consideration. I do not consider that Lord Diplock was there laying down a general proposition that an expense that is deductible can never be a tax benefit. His statement has to be read in context. He was dealing with the acquisition cost of stock-in-trade employed in the taxpayer's business which was deductible until section 111. In my view, it has no wider application.

79. The next relevant decision is that of Cross J (as he then was) in *Commissioner of Inland Revenue v Kleinwort, Benson Ltd* (1968) 45 TC 369. At the outset it should be said that the decision was not about the meaning of a "tax advantage" as defined in section 43(4)(g) of the Finance Act 1960 since in that case the taxpayer had conceded that it had as a result of the transaction obtained a "tax advantage" in that its assessment had been reduced by a deduction in computing its profits or gains (at 380I). The court was there concerned with, first, whether the tax advantage had been obtained in the circumstances mentioned in section 28(2)(b) and if so, whether the object or main object was the gaining of the tax advantage.

80. Although Cross J concluded that the tax advantage had not been obtained in the circumstances of section 28(2)(g) which would have disposed of the appeal, he went on to express a view on the second point. For that purpose it had to be assumed that the transaction fell within section 28 which was "aimed primarily at purely artificial transactions into which no one would have thought of entering apart from the wish to reap a 'tax advantage' " although it was so framed it also covered "bona fide commercial transactions which are combined with the securing of a tax advantage". Cross J noted that the transaction in question was "a single indivisible transaction … an ordinary commercial transaction, a simple purchase of debenture stock" rather than a transaction that could be divided into several parts. The question for determination was whether in entering into such a transaction the object of the taxpayer was to obtain a tax advantage. To illustrate his point, Cross J gave the example of a trader acquiring stock at £20 to be resold at a profit at £30. He went on to say this (at 382G):

> "If you choose to describe his right to deduct the £20 (very tendentiously be it said) as a "tax advantage", you may say that he intended from the first to secure this tax

> advantage. But it would be ridiculuous to say that his object in entering into the transaction was to obtain this tax advantage."

81. As noted above, whether a deduction can be a tax advantage was not itself an issue for decision in the *Kleinwort, Benson* case. Cross J's remarks suggest that he did not regard it correct to describe the trader's right to deduct the cost of the stock in the example he gave as a tax advantage. In any event, even if it could be so described, it would make no difference because I agree that it would be inconceivable that the gaining of a tax advantage through the right to make a deduction was the main object or purpose of the taxpayer in acquiring the stock.

82. Although I do not consider that there is any authority for the proposition that an expense that is deductible under section 16 can never be a tax benefit, equally Lord Diplock's statement in *Europa Oil* and Cross J's approach in the *Kleinwort Benson* case support the view that certain deductions cannot properly be regarded as a tax benefit. I am inclined to the view that whilst there is no intrinsic impediment or difficulty that would prevent a deduction from being a tax benefit, not every deduction is a tax benefit.

83. As to whether in this case there was a tax benefit, I find myself in agreement with Rogers VP that it is not. I agree with the statement of principle in paragraph 33 of his judgment with one proviso, namely, that 'liability' is to be read as including a potential liability to tax.

Sole or dominant purpose

84. If contrary to my view, section 61A applies to the present case on the basis that every deduction is a tax benefit, it will be necessary to consider the further requirement that, by reference only to the seven matters set out in section 61A(1), the sole or dominant purpose of one or more of the persons who had entered into or carried out the transaction was to enable the taxpayer to obtain a tax benefit.

85. The starting point has to be the Board's findings. Of particular relevance and importance are the following:

> "61. Under the 3 agreements, the parent company: -
>
> (a) would continue, without any stoppage, to carry on its core business of cotton spinning and yarn manufacturing in Hong Kong, initially at the old industrial building on Site I and subsequently at the new industrial building on Site III;
>
> (b) would no longer own any of the 3 Sites, but would have 2 wholly owned subsidiaries, the Taxpayer (carrying on business in property trading and investment) and the co-subsidiary (a property holding company);

(c) would have a residential estate (i.e. Tai Hing Gardens) in its name at Site I and Site II at no cost to the parent company;

(d) would receive a minimum of $346,309,452.06 and a new industrial building at a construction cost of approximately $193,000,000, and (if the redevelopment of Site I and Site II was profitable) the balance consideration under the Site I and Site II agreement for its sale of Site I and Site II to the Taxpayer;

(e) would be put in funds under the Site I and Site II agreement, sourced from Stanman, to acquire new, more compact and less labour-intensive machinery for use at the new industrial building; and

(f) would, presumably, receive consideration from the co-subsidiary for the parent company's sale of Site III to the co-subsidiary.

62. Under the 3 agreements, the Taxpayer:-

(a) would acquire Site I and Site II at no cost to itself, the acquisition being financed by Stanman;

(b) would probably go into liquidation if it should sustain any loss in the redevelopment, its paid up capital being $10,000; and

(c) would enjoy any net profit in excess of the balance consideration under the Site I and Site II agreement and would retain co-ownership (whether directly or through shareholding of another company) of the commercial portion of the redevelopment.

63. Under the 3 agreements, the co-subsidiary would acquire Site III with a new industrial building."

The Board then dealt with the 7 matters to which regard is to be had in paragraphs 78 to 91. Paragraph 85 read:

"85. In any event, the Board found that the consideration under clause *2* of the Site I and Site II agreement was not excessive and was realistic from a business or commercial point of view. The relevant time must be the time of making of the Site I and Site II agreement. The Board reiterated that neither the Taxpayer nor the parent company knew whether the redevelopment would be profitable. If the redevelopment should turn out to be very profitable, then the

> consideration would be increased accordingly. But, as Cons J. said in *Commissioner of Inland Revenue v D. H. Howe [1977]* HKLR *436* at *441 [(1977) 1* HKTC *936* at *p.952*]:-
>
> "What the taxpayer loses on the roundabouts he makes up on the swings".
>
> The Board reiterated paragraph 81 above. The Board also took into account the effect of interest on the deferred payment of the balance consideration."

The Board's overall conclusion appears at paragraph 92:

> "92. Having considered the strength or otherwise of the various resulting conclusions from considering the factors, the Board looked at the matter globally. The Board's overall conclusion was that the sole or dominant purpose was not the obtaining of a tax benefit. Any possible purpose of obtaining a tax benefit paled in significance to the purposes referred to in paragraphs 61, 62 and 63 above."

86. It is trite law that the Board's findings or conclusions of fact cannot be overturned on appeal unless they were perverse or wholly unreasonable. An appellate court cannot disturb the fact-finding tribunal's conclusion even if its own preference is for a contrary conclusion. See *Kwong Miles Services Ltd v Commissioner of Inland Revenue* [2004] 3 HKLRD 168 at para. 37. It is apparent from the judge's treatment of the 7 matters contained in section 61A that he failed to adhere to that fundamental principle. The following example serves to illustrate the point: notwithstanding the Board's finding at paragraph 85 of the case stated that the consideration under clause 2 of the Site I and II agreement "was not excessive and was realistic from a business or commercial point of view", the judge considered that the proceeds "far exceeded of the market value of the land" (at paragraph 74), that the consideration was "excessive" (at paragraph 75).

87. There were other errors of law in the judgment. It would suffice, for present purposes, to give a few examples. The judge opined (at paragraph 66) that the interposition of the taxpayer was "commercially unrealistic". But it is a commonplace phenomenon in Hong Kong to use a special purpose subsidiary company in property development projects. Indeed, as Mr Flesch pointed out, Stanman was itself such a special purpose vehicle. At paragraph 72, the judge accepted, *inter alia*, the Commissioner's criticisms of (a) the absence of any formal valuation for Sites I and II and (b) the Board failing to take into account the fact that the parent company was prepared to sell Sites I and II to the taxpayer involving millions of dollars without taking any security when the taxpayer had a paid-up capital of only $10,000 as being supportive of the view that the circumstances under which the Site I and Site II agreement was entered into were "commercially unrealistic". But it would appear that the judge had overlooked relevant evidence: as to (a), there was evidence in the form of a letter from Deloittes referring to valuation advice from Chesterton Petty given orally which was agreed and accepted by the joint venture parties and as to (b), there

was Hang Lung's guarantee of performance by Stanman. Accordingly, those criticisms being misplaced could not have undermined the Board's findings and conclusions.

88. I would also mention that the judge considered as irrelevant the question of interest that might otherwise have been paid on the Balance Consideration. I do not agree. It was a pertinent and material consideration for the reasons explained by Rogers VP in paragraph 40 of his judgment with which I agree.

89. At paragraph 87 of the judgment, the judge said this:

> "87. In my view, the above commercial purposes are not the dominant purpose of the Site I & II Agreement when the matter is viewed objectively and globally. The main objective of the Site I & II Agreement is to interpose the Taxpayer to effect a sale and purchase of the Sites between the Parent Company and the Taxpayer (within the same group) so that the land cost is structured in such a way that a significant portion the proceeds of the redevelopment (represented by the Balance Consideration) can be converted into a purported item of expenditure. The dominant purpose of the Site I & II Agreement is therefore to enable the Taxpayer to obtain a tax benefit in the form of reduction in the amount of tax, although there exist other legitimate commercial purposes. The Board had erred in arriving at a contrary conclusion."

I agree with Mr Flesch that what the judge sought to do there was to substitute his own views for those of the Board. Despite Mr Goldberg QC's efforts, no case has been made out for impugning the Board's findings or conclusions on the basis of perversity or otherwise. Accordingly, those conclusions must stand.

90. In conclusion, I agree with what is proposed in paragraph 41 of the judgment of Rogers VP.

Hon Rogers VP:

91. The appeal will therefore be allowed with a direction that the assessments of the taxpayer for the years 1995/96, 1996/97 and 1997/98 be remitted to the Commissioner for revision to give effect to the Decision of the Board of Review dated 29 March 2004. There will be an order *nisi* that the costs of this appeal and in the court below be to the taxpayer to be taxed if not agreed.

(Anthony Rogers)	(Robert Tang)	(Doreen Le Pichon)
Vice-President	Vice-President	Justice of Appeal

Mr David Goldberg QC & Mr Eugene Fung, instructed by Department of Justice, for the Appellant/Respondent

Mr Michael Flesch QC, Mr Clifford Smith SC & Mr Neil Thomson, instructed by Messrs Johnson, Stokes & Master, for the Respondent/Appellant