HCIA 14/2005 AND HCIA 15/2005

HCIA 14/2005

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

INLAND REVENUE APPEAL NO. 14 of 2005

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BETWEEN

HIT FINANCE LIMITED Appellant

and

COMMISSIONER OF INLAND REVENUE Respondent

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HCIA 15/2005

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

INLAND REVENUE APPEAL NO. 15 OF 2005

———————

BETWEEN

(2006-07) VOLUME 21 INLAND REVENUE BOARD OF REVIEW DECISIONS

HONGKONG INTERNATIONAL TERMINALS LIMITED Appellant

and

COMMISSIONER OF INLAND REVENUE Respondent

Before: Hon Rogers, Tang VPP and Le Pichon JA in Court
Date of Hearing: 14-17 November 2006
Date of Handing Down Judgment: 13 February 2007

J U D G M E N T

Hon Rogers VP:

1. These two appeals, which have come directly to this court from the Board of Review by leave given under the provisions of section 69A of the Inland Revenue Ordinance Cap. 112 ("the Ordinance"), were heard at the same time. Before turning to the questions raised on these appeals it is necessary to set out some of the background facts.

2. Hutchison Whampoa Ltd ("Hutchison Whampoa") is a well-known company listed on the Hong Kong stock exchange. It is the ultimate holding company of all the entities that are relevant on these appeals. Apart from its other interests, Hutchison Whampoa holds substantial interests in various port facilities and ports in Hong Kong, China and overseas. As with all major companies, these interests are and have been held through subsidiary companies. One of those companies has been Hutchison International Port Holdings Ltd ("Port Holdings") which is a BVI company. HIT Holdings Ltd ("HIT Holdings") has been an indirectly held subsidiary of Port Holdings. Originally HIT Holdings was not a wholly owned subsidiary because major outside companies held 22.5% of its shares.

3. In the early 1990s the port interests of Hutchison Whampoa began to expand because of investments not only in the United Kingdom but also in river ports in the Pearl River Delta and deep-water ports in Yantian, in Shenzhen, and in Shanghai. This expansion was capital

intensive. For example, even though Hutchison Whampoa only had a 62% interest in the Yantian development its share of the anticipated expenditure in the period up until early 1997 was some $3.8 billion. It thus came about that proposals were made to raise money. The Board referred in its decision to a letter from Wardley Capital Ltd ("Wardley") in March 1994. In that letter, Wardley outlined the terms whereby it would arrange the issue of US$1.78 billion 10 year fixed rate debentures, to be listed on the Luxembourg Stock Exchange. This was to be part of a transaction whereby the Hong Kong port interests would be transferred to a new wholly owned subsidiary. The subsidiary would use the proceeds of the debentures as part of the finance required to purchase the port. It would seem that the purchase price contemplated was not inflated because in May 1994 a valuation of the port interests was obtained which put them at HK$23 billion.

4. Wardley dropped out of the picture because their approach was thought to be too inflexible. Instead assistance was sought from other bankers. Banque Paribas seems to have been the entity that found favour and it became responsible for issuing floating rate notes, instead of fixed rate debentures, on the Luxembourg Stock Exchange. The interest rate was to be 0.85% above 6 month LIBOR. According to the evidence of Mr Pearson, the Deputy Managing Director, originally Banque Paribas considered that they could sell all the Notes.

5. Matters did not work out quite as originally contemplated. Despite the initial intention to raise the totality of the US$1.78 billion funds externally of the companies held directly or indirectly by Hutchison Whampoa that proved impossible because on 31 August 1994 Banque Paribas wrote a letter to Port Holdings setting out the terms of a collateral undertaking to be given by Port Holdings that one of the companies held by Port Holdings would purchase the US dollar equivalent of HK$9.2 billion of the HK$13.4 billion floating rate note issue.

6. In its decision, the Board was highly critical of the lack of evidence about how the final arrangements came about. In brief, the Hong Kong port facilities were transferred to a new subsidiary company. This was done by a sale agreement. The funds to purchase the Hong Kong port facilities by that subsidiary came from the issue of the floating rate notes in Luxembourg and instead of the majority of those notes being held by outside companies after they were issued, they were sold by Paribas Asia Ltd ("Paribas"), the lead manager of the issue, to another subsidiary company which was put in funds to acquire the debentures by means of an interest-free loan. The capital for that loan came from a dividend declared by HIT Holdings consequent upon the sale of the Hong Kong port facilities.

7. As described in the Board's decision, HIT Holdings' shareholders exchanged their shareholding for ordinary shares in HIT Investments Ltd. ("HIT Investments"). HIT Holdings then became a wholly owned subsidiary of HIT Investments. HIT Holdings entered an agreement to sell the whole of the undertaking in the Hong Kong port facilities to a new subsidiary, namely the taxpayer in HCIA 15 of 2005, Hongkong International Terminals Ltd ("HITL") for HK$23 billion. The contract provided that the purchase price was to be paid by means of a net cash payment of HK$10.4 billion, an inter-group loan due to HIT Holdings of HK$6.5 billion and an interest-free

shareholder's loan of HK$6.1 billion from HIT Holdings. HITL's net cash payment of HK$10.4 billion was to be paid out of a total of HK$13.4 billion which HITL was to borrow from another wholly-owned subsidiary of HIT Holdings, namely HIT Finance Ltd, which was to be the issuer of the notes and is the taxpayer in HCIA 14 of 2005.

8. When the floating rate notes were issued, the Listing Memorandum set out the scheme. It provided that immediately following the issue and listing the net proceeds of the issue of the notes, namely US$1.735 billion less selling, management and underwriting commissions and costs and expenses, would be lent to HITL and that not only would HITL use the net proceeds of the issue of the notes together with further borrowings of some HK$12.6 billion to purchase the Hong Kong port facilities but that there would be an unconditional and irrevocable guarantee by HITL.

9. There were a large number of managers of the floating rate notes but, as already noted, Paribas was the arranger and lead manager. Again it was disclosed in the Listing Memorandum that Paribas had agreed to sell approximately US$1.148 billion in principal amount of the notes subscribed for by Paribas to Strategic Investments International Ltd ("Strategic"), which was said to be "a company indirectly owned by the same group of shareholders that indirectly owned the Issuers and the Guarantors". It was then said that "Strategic's holding of Notes will be used for the purpose of providing the long term external funding requirements of the HIT Group and to that end it will consider from time to time the sale of the Notes to meet the HIT Group's future funding requirements…". It remains to be said that Strategic was also a British Virgin Islands company and had been incorporated on 7 March 1994.

10. As can be seen from this brief outline of what took place, there was what has been termed a circular transfer of monies. The capital raised by the issue of the floating rate notes by HIT Finance was lent to HITL. It was then paid to HIT Holdings as part of the purchase price for the port facilities. HIT Holdings promptly declared a dividend based upon the profit made on the sale. The dividend was paid to HIT Investments which made an interest-free loan to Strategic. Strategic used that money to discharge its obligation to purchase the notes representing the US dollar equivalent of HK$9.2 billion in respect of which the undertaking had been given. Strategic then held those Notes, which constituted valuable securities tradeable on the market. The interest payable on the floating rate notes sold by Paribas to Strategic thus became payable to Strategic. These floating rate notes were referred to as the Strategic Notes. Although originally the Commissioner had sought to charge Strategic with tax based upon the income derived from the notes, that attempt was eventually abandoned because it was appreciated that no tax was payable in respect of income received on the floating rate notes, whether by a Hong Kong company, a BVI company or any other company.

11. The Board analysed the transactions which took place on 28 November 1994, specifically the bank documents. It suffices to say that the bank documents namely the credit advices, the debit advices and the bank statements show at any rate that money was transferred.

The Board paid considerable attention to two credit advices from the Chemical Bank New York. One was timed at 9:38 a.m. and the second was timed at 9:44 a.m. From this it was deduced that Strategic paid Paribas for the Strategic Notes at 9:38 a.m. whilst HITL paid HIT Holdings only at 9:44 a.m. From all this, the Board concluded that "no real money was involved" in the transfers between the various accounts relating to these subsidiaries of HIT Holdings. The Board said at paragraph 71 of its Decision:

> "The evidence before us indicates clearly the existence of two paper trails as depicted in a chart submitted by Mr Goldberg Q.C. and annexed hereto as Appendix III. The first paper trail consists of the 0938 Advice and the 0944 Advice. US1,148,000,000 first arrived in New York from Singapore at 0938 as a payment from Strategic to PAL.. It returned to Singapore from New York six minutes later as a payment by HITL to HIT Holdings. No part of that was ever remitted to Hong Kong. The second paper trail consists of the various credit and debit notes and bank statements. They show that money had allegedly moved from PAL to HIT Finance; from HIT Finance to HITL; from HITL to HIT Holdings; from HIT Holdings to HIT Investments; and from HIT Investments to Strategic and from strategic to PAL. Strategic had allegedly paid to Banque Paribas at 0938 when it did not have the money to do so at that juncture. We accept the submission of Mr Goldberg Q.C. that no real money was involved in this second paper Trail. All that happened is that on an unknown date Strategic instructed its bank to pay US $1,148,000,000 to PAL for value at 28th of November, 1994. That instruction amounted to no more than a promise to pay ["the Promise"] albeit all parties concerned treated the Promise as money of an amount of US $1,148,000,000. On 28th November, 1994:
>
> (a) PAL treated itself as receiving the Promise;
>
> (b) PAL transferred the promise to HIT Finance and in return PAL received Notes with a face value of US$1,148,000,000.
>
> (c) PAL transferred the Strategic Notes to Strategic in satisfaction of its obligation to do so.
>
> (d) HIT Finance transferred the Promise to HITL and, in return, acknowledged its indebtedness to HIT Finance in the sum of US$1,148,000,000;
>
> (e) HITL transferred the Promise to HIT Holdings and HIT Holdings treated itself as having been paid the US$1,148,000,000 due to it on sale of the Port;
>
> (f) HIT Holdings declared a dividend in favour of HIT Investments. Part of the dividends was satisfied by the transfer of the Promise.

(g) HIT Investments treated itself as receiving the dividends in full and on lent the same including the Promise to Strategic.

Strategic did not actually have money to pay PAL until PAL had paid HIT Finance and money had passed around in a circle. At no time did PAL put any money into that circle. The Promise was all passed between PAL, HIT Finance, HITL, HIT Holdings, HIT Investments and Strategic. The Promise was cancelled out when the same eventually reverted back to Strategic as the original promisor. The issue of the Strategic Notes did not actually produce any money for HIT Holdings' business."

12. It is unnecessary to set out the full history of what took place after 28 November 1994. It suffices to say that some of the Strategic Notes were sold on the market in 1995 and some sold later to unconnected parties. All Notes were, apparently, redeemed by the end of November 2001. In 1996 Strategic was given the right to repay the outstanding loans to HIT Investments at any time. Appropriate amounts representing interest paid under the Strategic Notes and to HIT Finance were remitted to Paribas and HIT Finance respectively. Eventually the Strategic Notes were sold on the market and later redeemed by HIT Finance after HITL had borrowed an appropriate amount from Hutchison International Limited and repaid HIT Finance.

13. The dispute arose because it is HITL's case that it is entitled to deduct the interest paid to HIT Finance in respect of the loan when computing its profits and it is HIT Finance's case that it in turn is entitled to deduct the interest paid on the Strategic Notes when computing its profits including the profit derived from the loan to HITL. The Commissioner disallowed the deduction of the interest and issued additional profits tax assessments, in one case a profits tax assessment, for the relevant years on that basis in respect of HIT Finance. The Commissioner then did the same in respect of HITL, save that the assessments were made alternative to those of HIT Finance.

14. The Board came to the conclusion that in respect of HIT Finance section 61A of the Ordinance applied. In doing so it sought to identify the relevant transaction. In paragraph 75 of the decision in the HIT Finance appeal it referred to what were called a wider transaction and a narrower transaction and yet a third transaction which Mr Goldberg QC, who appeared on behalf of the Commissioner, had submitted in the course of the proceedings. The approach the Board adopted in relation to identification of the relevant transaction for the purposes of section 61A seems to be encapsulated in subparagraph 75(d) where the Board said:

"We see no reason why the borrowing, the on-lending and the guarantee cannot be regarded as three separate transactions. Whilst the issue was for a total of US$1,735,000,000, each of the Managers and Strategic (if Strategic did so subscribe) entered into a separate transaction with HIT Finance in relation to that portion of the issue that each had undertaken to subscribe."

15. Whilst the Board seems to have thus approached the matter on the basis that there were three transactions it said in paragraph 77(i):

> "Looking at the matter globally, we have no hesitation but to conclude that all the persons involved entered into or carried out the transaction for the dominant purpose of enabling HIT Finance to obtain a tax benefit. A facade was created so as to enable HIT Finance to seek a deduction, in computing Hong Kong taxable profits, the interest supposedly payable on the Strategic Notes and in the process removing value from Hong Kong free of Hong Kong tax."

16. Having reached their conclusion the Board held that the tax benefit should be counteracted and that all interest paid on the Strategic Notes should be disallowed. The Board then went on to consider the applicability of section 61 of the Ordinance. Basing itself on the requirement stated in the letter of 31 August 1994 from Banque Paribas that the US dollar equivalent of HK$9.2 billion should be purchased by one of the companies held by Port Holdings, the Board said that it had no difficulty in identifying the Strategic Notes as separate and distinct from the remaining Notes. In the following paragraph it said that there was never a borrowing of US$1,148,000,000 on the basis of the Strategic Notes and that no real money ever changed hands. The Board said that the "Strategic Notes are both artificial and fictitious." On that footing the Board considered that section 61 applied and that the assessor should disregard the Strategic Notes and assess HIT Finance by (dis)allowing all purported interest payable on the Strategic Notes for all periods they were in issue. In relation to the application of section 16 of the Ordinance the Board, again approaching the matter on the basis that no real money was raised, held that there could be no deduction of interest since interest had not been incurred.

17. In relation to HITL the Board reiterated that all that had passed between the parties was a "Promise" from Strategic which it said was designed to create an interest deduction in reduction of the tax payable by HITL. The Board referred to there being an alleged borrowing by HITL from HIT Finance and there being a pre-ordained facade with no capital sum being involved. In those circumstances the Board was of the view that all interest paid by HITL to HIT Finance on the "alleged" principal sum of US$1,148,000,000 should be disallowed. It also applied section 61 of the Ordinance on the basis that HITL did not in fact borrow any money. The curious conclusion to which the Board came was that neither HIT Finance nor HITL could deduct the interest paid in respect of their borrowings but HIT Finance had to account for the interest received from HITL and pay tax on it without deduction of interest paid on the Strategic Notes. The Revenue sought to allay this outcome, which clearly exceeds what might be considered in anyway reasonable, by announcing that by a stroke of administrative munificence it would not seek to disallow both companies' interest payments. It only remains to be said that if the Board's conclusions were indeed correct it is not for the Revenue to waive receipt of what should be a legitimate tax payment.

This appeal

18. Since this is an appeal on a question of law by way of case stated, it is important to concentrate on the questions that have been raised.

Question (A)(1) in the Case Stated of HIT Finance

19. The starting point of this consideration must therefore be question (A)(1) in the Case Stated of HIT Finance. That reads as follows:

> "(A) In relation to the Ramsay principle and Section 16 of the IRO:
>
> (1) whether in relation to the statement that "no real money was raised by the Strategic Notes" (paragraph 90 of the Decision and similar statements at paragraphs 71 and 72) the true and only reasonable conclusion is contrary to that as found by us."

20. This is a curiously worded question. If a Board were to find as fact that a transaction was fictitious and that although the Revenue had contended that no money had been raised or no payments had been made in particular by the taxpayer itself but also by others, it might be thought that it would make a finding of fact as to that. Rather in this case the Board itself has approached the matter on the basis that it is a legal conclusion to which it had arrived.

21. In my view, whether the statement is regarded as being a legal conclusion arrived at by the Board or a finding of fact, it is so wrong and unsustainable that it amounts to an error in law. Although Mr Goldberg complained that every scrap of paper had not been produced and that no evidence had been forthcoming from Cedex, the party responsible for supervising the issue of the floating rate notes in Luxembourg, the fact remains that it cannot be doubted that US$1,735,000,000 of floating rate notes were issued on the Luxembourg Stock Exchange on 28 November 1994. The listing documents namely the Listing Memorandum, the Subscription Agreement and the Agreement among Managers, all dated 23 November 1994, and the Fiscal Agency Agreement, the Reference Agent Agreement and the Deed, all dated 28 November 1994, were all produced and referred to by the Board. There is no suggestion that those documents were fictitious or of no effect. Indeed, the Commissioner acknowledged their effectiveness by only challenging the claim for deduction of interest on the Strategic Notes and not the claim in respect of interest in respect of the remaining US$587,000,000 Notes taken up by the remaining managers.

22. The Board's reference to "purported interest payable on the Strategic Notes" in paragraph 84 of the HIT Finance decision (and that no interest was payable), was a deduction which on the facts the Board was not entitled to make. The fact that there was an arrangement whereby the proceeds of the issue of the Notes purchased by Strategic from Paribas was

channelled back to discharge the purchase price payable by Strategic does not mean that money was not involved. The fact that a circular transaction might give rise to a suspicion that some manipulation was involved does not make the transaction unreal. The debiting and crediting of accounts clearly took effect and the bank was prepared to effect them even if some point might be made that the transactions could have been arranged in a sequence that would have satisfied a purist. The reality is that the Bank was assured of its money and was therefore not concerned to see that there was credit before a debit. It knew full well that the accounts would be squared off whatever the order the transactions might be argued to have been done.

23. More importantly it is clear that in the chain of transactions there was the payment of a dividend by HIT Holdings. It is impossible to hold that did not involve real money without also holding that there had been serious accounting deficiencies, if not fraud. As already indicated because of the involvement of shareholders of substance outside the Hutchison Whampoa group in HIT Holdings and subsequently in HIT Investments any suggestion that HIT Holdings had not had sufficient profits and liquidity to pay the dividend to HIT Investments after the sale of the Port would have to be justified by far more than a conclusion that there was some circularity in the transactions. Indeed, in considering this case generally, sight must not be lost of the fact that the raising of money by the flotation of the Notes on the Luxembourg exchange, enabled HIT Holdings to do 2 things. Firstly to realise a very substantial profit which could then be distributed and secondly to separate the existing port business in Hong Kong from the business that it was developing elsewhere.

24. I would conclude this aspect by pointing out that clearly there was real money. That real money was represented by the Strategic Notes. They could be sold and, indeed they were all sold at some stage to raise cash.

Question (A)(2) in the Case Stated of HIT Finance

25. The next question reads as follows:

> "(A) In relation to the Ramsay principle and Section 16 of the IRO:
>
> (2) whether, in the light of the Court's holding in relation to question (A) (1) above and the facts otherwise found by us, it was open to us to conclude that the deduction sought by HIT Finance for interest on Notes held by Strategic was not within the ambit of the section as:
>
> "No real money was raised by the Strategic Notes. As there was no capital sum, no interest was payable. The "interest" was not incurred in the production of profit. The "interest" was merely part of a facade to achieve a tax deduction" (paragraph 90 of the Decision)."

26. Following on what has been said above, it is clear that the answer to that question must be in the negative. There was real money, there was a capital sum and interest was payable.

Question (B)(3) in the Case Stated of HIT Finance

27. This question reads:

> "In relation, in particular, to Section 61A of the IRO:
>
> (3) whether on the facts found by us and in the light of the Court's holding in relation to question (A)(1) above, HIT Finance obtained a "tax benefit" as defined by Section 61A."

28. Again, this is a somewhat oddly phrased question. Nevertheless, on the basis that the court is asked to consider the matter in the light of the answer given to question (A)(1) the starting point must be that there was, albeit circular, a series of transactions which involved real money. In the series of transactions HIT Finance was a conduit for money. On the basis that that was real money, it clearly lent it to HITL. There is no suggestion that HIT Finance had any money to lend HITL other than money which had been raised by the issue of the Strategic Notes.

29. In the circumstances of HIT Finance's business, the capital that it lent to HITL was the equivalent of its stock-in-trade. By drawing a distinction between the Strategic Notes and the remaining Notes issued on the Luxembourg Exchange, the Board implicitly recognized the validity of the costs involved in acquiring and maintaining that stock-in-trade in relation to the remaining Notes other than the Strategic Notes. Indeed, there was no suggestion that the costs involved in relation to the Notes, other than the Strategic Notes, was anything other than proper.

30. What seems to be the difficulty in the matter is not that there was a circular transaction which enabled HITL to purchase the Port and HIT Holdings to realise a profit and declare a dividend, but whether there was maintenance of the Strategic Notes at a time when they could have been redeemed and or alternatively, perhaps, the issue of the Notes was in excess of what was required for business purposes. By concentrating, as the Revenue and the Board have done, on some notion that there was a fictitious transaction and that no real money was involved, the Board has not considered what appear to be the relevant considerations. Those considerations include whether it was necessary to issue the amount of Notes that were issued; was it necessary for HIT Investments to keep the whole of the dividend from HIT Holdings in a state where it could be used to finance new developments by, so to speak, parking it with Strategic; could HIT Investments have lent some or all of the dividend to either HIT Finance or HITL on an interest free basis and whether some of the Notes could have been redeemed earlier than they were.

Question (B)(4) in the Case Stated of HIT Finance

31. That question reads:

> "Whether, on the facts found by us and in the light of the Court' s holding in relation to question (A)(1) above, it was open to us to conclude, having regard to the seven factors set out in Section 61A(1) that the sole or dominant purpose was to obtain a "tax benefit" (as defined) for HIT Finance."

32. Again here the difficulty with the question is that it is predicated on the answer to question (A)(1). Since the Board has dealt with the matter on the basis of the transaction being fictitious and there being no real money and since that finding cannot stand, the answer to this question must, again be in the negative.

Question (C)(5) in the Case Stated of HIT Finance

33. This question reads:

> In relation, in particular, to Section 61 of the IRO:
>
> (5) whether, on the facts found by us and in the light of the Court' s holding in relation to question (A)(1) above, there was any transaction which reduced or would reduce the amount of tax payable by HIT Finance as required by Section 61.

34. Apart from the fact that this question is predicated on the answer to the first question, the closing words of this question bring into focus the importance of the correctness or otherwise of the finding in relation to the whether the transaction or transactions were fictitious. Section 61 of the Ordinance reads:

> "Where an assessor is of opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the person concerned shall be assessable accordingly."

35. As already noted the Board' s finding that money was raised by Strategic Notes which were both artificial and fictitious is not merely unsustainable but so demonstrably wrong as to constitute an error in law. In those circumstances the only answer to this question can be in the negative. The simple point is that there remains no sustainable basis upon which it can be said that there was a transaction which was artificial or fictitious.

Question (C)(6) in the Case Stated of HIT Finance

36. This question is very similar to the previous question and is answered in the same way. It reads:

> "Whether, on the facts found by us and in the light of the Court's holding in relation to question (A)(1) above, it was open to us to conclude that the "Strategic Notes are both artificial and fictitious"."

Question (D)(7) in the Case Stated of HIT Finance

37. This question comes under a category which has been headed "Generally" and reads:

> "Whether it is permissible, in applying Section 61A. Section 61 or the Ramsay principle and Section 16 to the facts of this case, to exclude the deduction for tax purposes of interest shown as payable by the taxpayer in its computations, whilst leaving the income shown as arising in the taxpayer's computations assessable to profits tax without a deduction for all the interest so shown."

38. The reference to "the facts of this case" is somewhat ambiguous. If it is a reference to the facts as found by the Board, then for the reasons which have already been given, the answer to the question must be in the negative. Furthermore, the facts found by the Board that are sustainable do not indicate any reason why HIT Finance should not be in a position to deduct the cost of acquiring the capital which is being on-lent to HITL. As already noted, there is no suggestion that HIT Finance had any money of its own and in the absence of any finding that the borrowing and on-lending by HIT Finance was an unnecessary interposition of a step there would be no scope for the application of the *Ramsay* principle.

39. Furthermore, in the application of the *Ramsay* principle it would be surprising if the conclusion were reached that the amount received in income generated by the lending of the amount by HIT Finance were not treated in the same way as the expenses incurred in raising that money. The essence of the *Ramsay* principle is to disregard unnecessary transactions, not to manipulate accounts in a way that partially acknowledges the existence of a transaction and at the same time rejects it.

40. For the reasons already given, section 61 of the Ordinance would appear to be inapplicable. In relation to section 61A of the Ordinance, on the conclusion reached by the Board there is the added conundrum that it is difficult to discern a rational basis for the Board, after coming to the conclusion that there was no real money involved in the whole transaction and that it was all fictitious, holding that tax should be chargeable on any sums received by HIT Finance from HITL. On the Board's conclusion such sums cannot have constituted interest because there was no capital lent or borrowed. If the Board's findings stood, the payments could only have been gifts or perhaps payments made under a mistake of fact and liable to be repaid.

41. The sustainable facts found by the Board do not inevitably give rise to the conclusion that there was a tax benefit nor that it was the sole or dominant purpose of one of the parties who entered or carried out the transaction to obtain a tax benefit. In the judgment in *Commissioner of Inland Revenue v Tai Hing Cotton Mill (Development) Limited* CACV 343 of 2005, 22 December 2006, I reached the conclusion that the capital cost of stock-in-trade cannot be considered a tax benefit for the purposes of section 61A of the Ordinance, if the use of that stock-in-trade results in the generation of income which forms the basis of the assessment of the relevant profits. The matter, however, may be different in relation to the cost of long-term financing commitments. Although the cost of the financing may fall within the provisions of allowable deductions under section 16(2) of the Ordinance, financing, whether it be the financing of the cost of stock-in-trade or any other expenditure, is not an inseparable and integral part of the process of acquisition and disposal of stock-in-trade.

42. The point that falls to be decided here is whether in relation to a business which consists of lending money the cost of raising and maintaining the money to be lent comes within the same category as a capital cost of acquisition of stock-in-trade. Although I have some sympathy for the point of view, I consider that strictly speaking it does not. That said I find it difficult to see how a company that carries on a business that consists solely of borrowing money and lending it at a higher rate of interest can be said to be gaining a tax benefit when it incurs interest costs. Section 61A of the Ordinance is directed to a tax benefit being obtained by the taxpayer. The taxpayer in the circumstances of a finance company is not obtaining a tax benefit by paying interest. It may be that some other party gains a benefit by receiving that interest, particularly if it does not have to pay tax on the interest received, but that the section is only directed to a tax benefit accruing to the taxpayer and not anyone else. Hence, unless there are other grounds for impugning the transaction, the cost incurred by HIT Finance in raising the capital sum to be used for on-lending to HITL did not come within the meaning of tax benefit. It was the equivalent of the cost of acquisition of stock-in-trade.

43. Even if one were to say, tendentiously using the words of Cross J, that there was tax benefit simply because the interest was an amount that could be used is assessing the taxable profits, there has been no identification in the Board's decision of the party said to have had the sole or dominant purpose of the taxpayer receiving a tax benefit nor of the factors that would give rise to that conclusion.

Question (D)(8) in the Case Stated of HIT Finance

44. The final question in the HIT Finance appeal was:

> "Whether, on the facts found by us and in the light of the Court's holding in relation to question (A)(1) above and the law determined by us or the law that should have been determined, there were any grounds in law for dismissing the appeals and upholding and increasing the assessments."

45. Again, since this question is predicated upon the answer to question (A)(1) that question must be answered in the negative. It does not necessarily preclude any conclusion that the Board should have dismissed the appeals if other facts had been found.

Question (A)(1) in the Case Stated of HITL

46. The first question in relation to the HITL appeal reads:

> (A) In relation, in particular, to Section 61A of the IRO:
>
> > (1) whether, in the light of the Court' s holding in relation to question (A)(1) in the Case Stated of HIT Finance and the facts otherwise found by us, HITL obtained a "tax benefit" as defined by Section 61A.

47. In the light of the answers given above, consideration has to be given to the other facts found by the Board. In this respect the most important matter is the long-term finance commitments entered into by HITL. For the reasons which I shall give in paragraphs 50 and 52 below I would answer this question in the negative.

Question (A)(2) in the Case Stated of HITL

48. This question reads:

> "*(A) In relation, in particular, to Section 61A of the IRO*
>
> ……
>
> Whether it was open to us to identify a transaction as being the borrowing of money by HITL from HIT Finance and then to disregard or exclude the same under Section 61A (and Section 61) whilst leaving HITL in the position of having acquired the Port on the terms on which it, in fact, did so."

49. The first point to be noted here is the matter of the identification of a transaction. Mr Goldberg contended in this court, as indeed before the Board, that it was open to the Revenue to identify a transaction right up until the closing stages of the case, if necessary before the Court of Final Appeal. What course the Court of Final Appeal might take is not a matter for this court, but as regards the presentation of cases in this court I consider it is incumbent on the parties to present a consistent case. Obviously minor alterations to the wording of propositions can be made, but I see no basis upon which it would be right to allow such a peripatetic approach to the formulation of a case whether it be by the Revenue or anybody else.

50. For the reasons already expounded, namely that the Board's conclusion, as to there being no real money and the transfer of money being fictitious, is unsustainable section 61 of the Ordinance is inapplicable. The borrowing of money by HITL from HIT Finance could only be disregarded under the provisions of section 61A(2) of the Ordinance if not only were it held that there had been a tax benefit but also that the sole or dominant purpose of one of the parties who entered into or carried out the transaction was that HITL would receive that tax benefit. In this respect it must be noted that if, according to the question posed the transaction is narrowed down to "the borrowing of money by HITL from HIT Finance", then the intention of any other party which was not party to that transaction, for example HIT Holdings or Port Holdings, would be irrelevant. On the sustainable facts found by the Board it would be impossible to conclude that the sole or dominant purpose of HIT Finance in lending the money to HITL had been that HITL should receive a tax benefit. It was obviously a natural consequence of the payment of interest incurred in the course of business that that payment should be taken into account for the purposes of assessing tax. But that does not mean that it was the sole or dominant purpose of the lending company that the borrowing company should gain a tax benefit. Likewise, similar considerations apply in relation to the borrower, namely HITL.

Question (A)(3) in the Case Stated of HITL

51. The question posed here is:

> *"(A) In relation, in particular, to Section 61A of the IRO*
>
> ……
>
> whether, on the facts found by us and in the light of the Court's holding in relation to (A)(1) above, it was open to us to conclude, having regard to the seven factors set out in Section 61A(1) that the sole or dominant purpose was to obtain a "tax benefit" (as defined) for HITL."

52. If in framing the question of the Board did so on the basis that the transaction was the borrowing and lending of money between HITL and HIT Finance, the same conclusion follows as above. If, however, the question has been put on the basis that the transaction in question was the series of transactions as outlined in paragraphs 5 to 10 and above, as already referred to, I consider that has not been made out on the sustainable facts found by the Board. Looking at the wider picture for the reasons set out in paragraph 30 above the facts have not been considered which would be necessary if the conclusion were to be reached that it was the sole or dominant purpose of Port Holdings, or any other company in the Hutchison Whampoa Group. As also noted above before any conclusion as to sole and dominant purpose can be reached in relation to the transaction it is very important to identify the transaction. If it is the wider transaction the significance of the realisation of a profit in HIT Holdings and the separation of the port businesses are factors which cannot be ignored.

Questions (B)(4)and (5) in the Case Stated of HITL

53. These questions are directed to section 61 of the Ordinance. They read:

> "(B) In relation, in particular, to Section 61 of the IRO:
>
> (4) whether, on the facts found by us and in the light of the Court's holding in relation to (A)(1) above, there was any transaction which reduced or would reduce the amount of tax payable by HITL as required by Section 61.
>
> (5) whether, the true and only reasonable conclusion is contrary to that found by us as follows:
>
> "HITL did not in fact borrow money from HIT Finance to the extend of US$1,148,000,000. The alleged borrowing was merely part of the facade to secure an interest deduction". (Paragraph 7 of the Decision)"

54. The answers to these questions follow what has already been said in respect of Questions (C)(5) and (6) in respect of HIT Finance. Section 61 is inapplicable because the Board's basis for saying that the transactions were artificial and fictitious is unsustainable. The answer to Question (B)(4) must, therefore, be in the negative and Question (B)(5) in the affirmative.

Question (C)(6) in the Case Stated of HITL

55. This is again a curious question which, in effect, asks whether the Decision of the Board was correct in the light of the answer to Question (A)(1) in the HIT Finance case. It reads:

> "(C) Generally:
>
> (6) whether, on the facts found by us and in the light of the Court's holding in relation to (A)(1) above, there were any grounds in law for dismissing the appeals and upholding and increasing the assessments"

56. Again, the answer to this question must be in the negative. Usually appeals are approached on the footing that the Court determines whether there are grounds for allowing an appeal, albeit section 68(4) of the Ordinance places the burden of proving that the assessment appealed against is excessive or incorrect on the taxpayer. Be that as it may, for the reasons already stated the facts upon which the Board based its decision cannot stand and the Board did

not find any other facts which would have made the relevant sections, namely 16, 61 and 61A, applicable.

Question (C)(7) in the Case Stated of HITL

57. This question is directed to whether, the Board having held that the payments by HITL had to be taken into account as interest paid to HIT Finance for the purposes of calculation of HIT Finance' s tax liability, it was open to the Board to hold that those payments could not be used in the computation of HITL' s tax liability. The question reads:

> "Whether, having found that Section 61A and 61 applied in the case of HIT Finance, so as to charge that company to tax on the sums shown in its computations as interest paid to it by HITL, it was open to us, on the basis of the same facts and reasoning, to find that they also applied in the case of HITL so as to exclude or limit its deduction for the same sums shown in its computation as paid by it as interest; and especially so having regard to the fact that all assessments on HITL have been raised in the alternative to those on HIT Finance."

58. That question, however, seems to be inapplicable or at the very least, wrongly framed. It does not appear that there was ever any dispute by HIT Finance that it had to take into account the receipt of payments of interest by HITL. The dispute in HIT Finance' s case was as to whether HIT Finance was entitled to take into account the payments of interest on the Strategic Notes. The Board held that section 61 and 61A prevented HIT Finance from so doing. What, perhaps, the Board might have asked was whether, in the light of its holding that there was no real money which passed from HIT Finance to HITL, any payments made by HITL to HIT Finance could be regarded as interest payments or otherwise payments received in the course of business which would be taxable rather than simply gifts.

Conclusion

59. In the circumstances, having answered the questions raised in the two Cases, I would allow these appeals and remit the matter to the Board accordingly. I appreciate that in answering the questions raised, the unsatisfactory nature of the case stated procedure may be highlighted. As is explained in paragraph 244 of Le Pichon JA's judgment, the case stated procedure does not encompass a further fact finding role by the Board. I would, nevertheless, give liberty to the parties to apply for any further or other directions as they may deem appropriate.

Hon Tang VP:

HITL's appeal

Introduction

60. This is Hong Kong International Terminals Limited's ("HITL") appeal by way of case stated under section 69A of the Inland Revenue Ordinance, Cap. 112, from the Board of Review to this court.

61. HIT Holdings Ltd ("HIT Holdings") was prior to 28 November 1994 known as Hutchison International Terminals Ltd, hence HIT.

62. HIT Holdings was the owner and operator of Kwai Chung Terminals 4, 6 and 7.

63. As a result of the restructuring in 1994, HIT Holdings (i) sold Kwai Chung Terminals 4, 6 and 7 ("the Port") to HITL; ii) acquired interests in, inter alia, the container port to be constructed in Yantian PRC, (iii) became a wholly owned subsidiary of HIT Investments Ltd ("HIT Investments").

64. Hutchison Whampoa Ltd ("HWL") was the ultimate holding company of all the HIT companies as well as Strategic Investments Ltd ("Strategic"). The other HIT companies are HIT Finance Ltd ("HIT Finance"), wholly owned by HIT Holdings, HIT Investments Ltd ("HIT Investments"), the immediate holding company of HIT Holdings as from 25 November 1994.

65. This appeal concerns the tax consequence of the way in which the acquisition by HITL of the Port was financed.

Background

66. By the Sale and Purchase Agreement dated 28 November 1994 ("the Port Purchase Agreement"), HITL purchased from HIT Holdings, the assets employed in or relating to the business formerly carried on by HIT Holdings at Kwai Chung Container Port Terminals 4, 6 and 7 ("the Port"), together with other assets and subject to liabilities of that business for a purchase price of HK$23 billion. Clause 3 of the Port Purchase Agreement provided that the consideration of HK$23 billion was to be paid in the following manner:

(a) HK$10,394,275,824 "shall be payable forthwith by [HITL] to [HIT Holdings] upon [HITL] receiving from [HIT Holdings] written demand to pay the same". HK$10,394,275,824 was equivalent to US$1,345,833,493.97 at the applicable rate of exchange.

(b) HK$6,100,000,000 shall be payable by [HITL] issuing an interest fee subordinated loan note in that amount to [HIT Holdings].

(c) HK$6,505,724,176 shall be payable by HITL to HIT Holdings in a form of a back to back loan note whereby HITL undertook to pay interest and capital to HIT Holdings sufficient enable HIT Holdings to pay and repay banks on borrowings which it had occurred.

67. Completion was to take place on 28 November 1994, or such later date as the parties might agree in writing prior to completion. Clause 6 of the Port Purchase Agreement further provided that following completion, the agreement should be deemed to take effect from the start of business on 1 June 1994.

68. We are only concerned with the payment of HK$10,394,275,824.

69. It is HITL' s Case that it paid HK$10,394,275,824 to HIT Holdings on completion by means of a loan of US$1,735,000,000 (after deduction of expenses which I ignore for the purpose of this judgment), made by HIT Finance to HITL at interest of 1% over 6 months' LIBOR. This loan is evidenced by a loan note dated 28 November 1994.

70. HIT Finance on its part was able to make the loan to HITL as the result of the issuance of guaranteed floating rate notes ("the Notes") listed on the Luxembourg Stock Exchange with a face value of US$1,735,000,000 which at the applicable rate of exchange, was the equivalent of HK$13,400,000,000. Interest on the Notes was payable at the rate of 0.85% per annum over 6 months' LIBOR. Subject to earlier redemption, the Notes were due to mature 10 years from the issue date. The due and punctual payment of principal and interest in respect of the Notes were unconditionally and irrevocably guaranteed by HITL and irrevocably guaranteed by another associate company, Lunogo Limited (a member of the HIT Group, which held cash and marketable investments financed by a subordinated loan from HIT Holdings) to the extent of HK$500,000,000.

71. The Notes were arranged by Paribas Asia Limited ("PAL"). It is important to note that although PAL undertook to subscribe for US$1,208,000,000 of the Notes, Strategic agreed to buy approximately US$1,148 million of the Notes from PAL.

72. As a result of this arrangement, Strategic eventually purchased US$1,148 million of the Notes, which can for convenience sake be referred to as the Strategic Notes. However, as admitted by HITL, the purchase by Strategic of the Strategic Notes was financed by a circular transaction involving HITL. The transaction is circular, thus the Board held that "no real money" was involved and essentially for that reason disallowed the deduction. As the paper trail conducted by the Board showed, Strategic had no money to buy the Strategic Notes until it was lent the money by HIT Investments; HIT Investments relied on the dividend of US$1,255,938,818.47 from HIT Holdings; HIT Holdings paid the dividend out of the part payment of purchase price

(US$1,345,833,493.97) by HITL. HITL in turn was lent the proceeds of the Notes by HIT Finance (US$1,735,000,000) which included the payment by Strategic for the Strategic Notes.

73. HITL has made a substantial profit from its operation of the Port. The amount of profit (chargeable to profits tax) for all years that are the subject matter of the assessments raised is as follows:

Year	HK$
1995/1996	1,438,562,721
1996/1997	2,422,776,308
1997/1998	2,734,908,928
1998/1999	2,435,427,181
1999/2000	2,626,916,252
2000/2001	2,412,687,765

74. In computing and calculating its profits, a deduction was made by HITL for the interest paid to HIT Finance.

75. HITL has paid interest at 1% over LIBOR in respect of US$1,735 million. However, the deductibility of interest in respect of only $1,148 million (represented by the Strategic Notes) is in issue. The Revenue accepted that interest in respect of the balance is deductible. To me, the essential difference between the Strategic Notes and the balance of the Notes is that the Strategic Notes were purchased by Strategic, a company within the HWL Group. This may be important when one comes to consider whether it was part of a transaction to avoid or reduce liability to tax. The Commissioner in his determination held that section 61A applied and the deduction should be disallowed. On appeal, the Board held that the deduction should be disallowed under section 61 as well as under section 61A.

76. On HIT Finance's part, it has paid tax on the 0.15% difference in the interest. However, the Commissioner has disallowed the deduction of the interest which HIT Finance had to pay on the Strategic Notes. The Board has affirmed that decision. That is the subject of HCIA 14 of 2005.

77. Strategic on its part received interest income on the Strategic Notes and made some profits on the sale of the same and paid dividends to its shareholder. The interest income it derived from the Notes is the subject matter of a further related appeal by Strategic in Appeal No. B/R 47/03. However the assessment was abandoned before the Board.

78. Thus, this is one of two appeals which were heard by us. The other appeal was by HIT Finance (HCIA 14 of 2005). The Revenue chose to put its case against HIT Finance at the forefront, and regarded the assessments against HITL as an alternative, such that in the Revenue's HITL determination dated 30 May 2003, it said in respect of its determination against HIT Finance that "if this determination [i.e. the determination against HIT Finance] is correct, the alternative

assessments raised on HITL [Fact (47)] should be cancelled. However, if the determination is incorrect, it would be necessary to determine whether the alternative assessments should be allowed to stand" para 3(1) at page 28.

79. However, by the time of appeal came before by the Board, the Revenue no longer regarded the assessments against HITL as alternatives. Indeed, according to Mr Goldberg, the Revenue was entitled to enforce the assessments against both HIT Finance and HITL, and that HIT Finance and HITL were fortunate that the Revenue had indicated that it would not seek to recover from both.

80. At the hearing before us, as it was before the Board, the case relating to HIT Finance was argued first. Little was added in respect of HITL's appeal. Indeed, Mr Goldberg's skeleton submission covered both appeals and little distinction was made between them.

81. I said during the hearing that I thought it would have been more logical to deal with the assessments against HITL first, seeing that it was HITL which made the profits and paid the interest which became the profits of HIT Finance.

82. On reflection I believe the order in which the Revenue has chosen to deal with the two companies has obscured some important points.

83. It is important to note that section 16 was not invoked in the Determination against HITL. Nor by the Board. The Board's decision against HITL was based on section 61 and section 61A. However, in Mr Goldberg's skeleton submission before us which, as I have said, dealt with both appeals, it seemed that the Revenue's case against HITL was also based on section 16.

84. It is undeniable, indeed, implicitly recognized by the Revenue, that HITL has acquired the Port and borrowed and paid money in respect of the Port. Thus, interest on the non-Strategic portion of the Notes, has been allowed to be deducted under section 16. That could only have been done on the basis that those were moneys "borrowed by [HITL] for the purpose of producing such profits" (section 16(1)(a)) and that such interest were "outgoings and expenses to the extent to which they are incurred by [HITL] in the production of profits" (section 16(1)). The principal sums in respect of which such deduction was allowed included, not only the difference between US$1,735,000,000 borrowed from HIT Finance and US$1,345,833,493.97, being the HK$10,394,275,824 payable under the Port Purchase Agreement, but also the difference between US$1,345,833,493.97, the amount paid by HITL to HIT Holdings, and US$1,148 million, the amount of the Strategic Notes.

85. Thus, the reality of the purchase of the Port by HITL and HITL's payment of the relevant consideration for the Port cannot be disputed. Nor that HITL paid interest out of its earnings from the Port.

86. The only question is whether the Board was right in its conclusion that "no real money" was involved in the Strategic Notes, so that insofar as the loan from HIT Finance included the proceeds from the Strategic Notes, that part of the loan was unreal.

87. Mr Gardiner submitted on behalf of the taxpayer that it is clear that the intention was that the fund flow expected on 28 November 1994, should start with payments of US$1,735 million from all the subscribers, including PAL as to US$1,208 million less PAL's expenses, and that the various other transactions would occur so that from those proceeds of the note issue and the other transactions, Strategic would be put in funds to purchase US$1,148 million of the Notes which it had agreed to acquire from PAL.

88. According to the documents produced by HITL, HIT Finance was credited with the proceeds from Strategic's purchase of the Strategic Notes by "the 0938 Advice". However, as the Board noted HITL only paid US$1,345,833,493.97 to HIT Holdings by the telex transfer of 0944 [the 0944 Advice].

89. On such evidence the Board concluded that there was "no real money" and the Strategic Notes were never paid for. It also held that HITL never borrowed what was supposed to have been the proceeds of the Strategic Notes.

90. In my view, absent a bridging loan, Strategic was unable to pay for the Strategic Notes until after HITL had been lent the proceeds of the Notes by HIT Finance which in turn depended on payment by Strategic for the Strategic Notes.

91. The Board said in relation to section 61A that "HITL did not in fact borrow any money from HIT Finance to the extent of US$1,148,000,000. The alleged borrowing was merely part of the façade to secure an interest deduction." para. 7. And in relation to section 61A that:

> "5. Having regard to the fact that the alleged borrowing by HITL from HIT Finance was part of a pre-ordained façade; the fact that it created in form a loan relationship but in substance a claim for interest deduction when no capital sum was involved; the fact that but for section 61A HITL would have secured a reduction of its assessable profits; the fact that the financial position of HITL may reasonably be expected to be weakened by the transaction; the fact that value would move out from Hong Kong in favour of Strategic and the fact that between persons dealing with each other at arm's length one would expect real money passing in support of any loan, we conclude that HITL entered into the transaction for the dominant purpose of obtaining a tax benefit."

92. Much of the arguments advanced by the Revenue before the Board was directed towards:

1) the circularity of the movement of funds; and

2) an apparent inconsistency between two telexes "the 0938 Advice" and "the 0944 Advice", between Banque Paribas, and its bank, Chemical Bank of New York, on the other hand, and on the other, the cash flow flowing from the contractual documentation and the instructions given by the various companies involved to the bankers.

93. However, I agree with Mr Gardiner that the circularity is not determinative of any issue in this appeal. The following words of Lord Millett in *Peterson v Commissioner of Inland Revenue* [2005] STC 448 at 460 explain why:

> "[45] The circular movement of money sometimes conceals the fact there is no underlying activity at all. But each of the payments in the circle must be examined in turn to see whether it discharged a genuine liability of the party making the payment. It does not matter whether external funds were introduced into the circle or whether cheques were handed over and duly honoured. If the money movements did not discharge a genuine liability the introduction of external funds will not save it; if they did, their absence will not affect it. In either case the payments are interdependent, in the sense that each of the payments is dependent on the receipt which funds it and each receipt on the payment by which it is funded."

94. As I have said, it is uncontrovertible that pursuant to the Port Purchase Agreement, HITL had acquired assets from HIT Holdings and that the relevant part of the consideration was paid on 28 November 1994, and that it was able to do with the monies lent to it by HIT Finance. The implicit acceptance up to the hearing before the Board in relation to HITL, that some interest was deductible under section 16, is consistent only with that view.

95. There was nothing unreal about the so-called Strategic Notes. On the evidence, it is quite clear that such notes were eventually sold into the market and ultimately redeemed. Whatever the Board might have meant by "no real money", it is clear that the Strategic Notes had legal as well as commercial effect.

96. Mr Gardiner further submitted that the telexes might have been sent in the wrong order, and, if so, that was an error on the part of the Chemical Bank and HITL was not responsible for it.

97. Mr Goldberg submitted on the other hand, that error or not, at the time Strategic "paid" for the Strategic Notes it had no money. So it is basically part of the circularity argument.

98. In the absence of evidence from PAL or Chemical Bank, I cannot conclude that there was any error in the order of the telexes. Nor do I think that mattered. As I see it, the difficulty about the order of the payment is inherent in its circularity. As explained above, Strategic could not pay for the Strategic Notes, unless HITL had paid the purchase price to HIT Holdings, and HITL' s ability to pay depended on the proceeds of the Notes (including the Strategic Notes) being made available to it by HIT Finance.

99. But, the commercial and legal reality was that the circular transaction was intended to be carried out on 28 November 1994 and that at the end of that day, it had been carried out. So that HIT Holdings could not say at the end of the day that it had not been paid the relevant purchase price. Nor that it had not declared a dividend to HIT Investments. Nor could HIT Investments say that it had not received the dividend or not made the loan to Strategic. Nor that HITL had not borrowed from HIT Finance. And so on.

100. So far as the parties were concerned, and in this context I include Banque Paribas and the Chemical Bank, it could not be said that at the end of the day on 28 November 1994, the loan transaction had not been effectively concluded. I do not see how the Chemical Bank, Banque Paribas, or any of the other parties could be heard to say in any court of law that no loan had been made or that no payment had been effected. Nor would I agree with Mr Goldberg that since the burden of proof is on the taxpayer, the taxpayer could be said to have failed to discharge its burden. It is not suggested that apart from the possible tax consequence, the absence of "money" can have any other consequence.

101. The Board demonstrated that the paper trails showed that there was a 0938 advice which evidenced payment from Strategic to PAL, from Singapore to New York, which then returned to Singapore from New York 6 minutes later at 0944 as a payment from HITL to HIT Holdings. But I do not believe that mattered at all. It is not in dispute that the funding of the transactions leading to Strategic' s acquisition of US$1,148 million of the Notes was circular in that Strategic would have had to be put in funds by HIT Finance borrowing the full amount of US$1,735 million, lending on the same to HITL and so on, to enable Strategic to purchase those Notes. Indeed, Mr Goldberg did not suggest that if this had been a vendor financed sale, and the vendor and the purchaser were dealing at arm' s length, the fact that the payment was circular would without more render the loans or payments unreal.

102. *Peterson v Commissioner of Inland Revenue* [2005] STC 448, was a case on section 99 of the New Zealand Income Tax Act 1976, a general anti-avoidance provision, and which involved circular payment since part of the payment for the films to be produced was paid for by the investors out of a non recource loan made by lenders, to whom the loan was returned by the film production company. No point was taken about the circularity of payment, although in relation to one of the films:

> "… it could be said that the investors did not merely indirectly procure the lender to make the loan by paying money to the production company but the lender's ability to lend money to the investors depended on the indirect receipt of money from them." per Lord Millett at para. 50

That did not affect the deductibility of the expense of money incurred by the taxpayer.

103. With respect to the Board, their concentration on the source of the money and the order of the telexes diverted their attention from the real issues before them.

104. As I see them, the real issues are:

1) whether the interest paid by HITL to HIT Finance is deductible under section 16.

2) if so, is it otherwise covered by section 61 or section 61A.

105. Section 16 provides:

> "(1) In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period, including-
>
> (a) where the conditions set out in subsection (2) are satisfied, sums payable by such person by way of interest upon any money borrowed by him for the purpose of producing such profits, and sums payable by such person by way of legal fees, procuration fees, stamp duties and other expenses in connection with such borrowing;"

106. The condition which has to be satisfied in subsection (2) so far as HITL is concerned is paragraph (c):

> "(2)(c) the money has been borrowed from a person other than a financial institution or an overseas financial institution and the sums payable by way of interest are chargeable to tax under this Ordinance;"

107. So far as HIT Finance is concerned, the condition to be satisfied under subsection (2) is paragraph f(ii) by virtue of the listing of the Notes in Luxembourg.

108. So far as section 16 is concerned, and the *Ramsay* principle, the Board had proceeded on the basis that:

> "… no real money was raised by the Strategic notes. As there was no capital sum, no interest was payable. The 'interest' was not incurred in the production of profit. The 'interest' was merely part of a façade to achieve a tax deduction. The deduction sought is clearly not within the ambit of section 16." see para. 9 of the decision in D97/04 which was repeated in D98/04.

109. Although section 16 was not relied on so far as HITL was concerned before the Board, Mr Goldberg argued the appeal before us on the basis that HITL could not have deducted the interest under section 16.

110. That was his argument in relation to HIT Finance, before us as well as before the Board, and the Board decided against HIT Finance, on the basis that the interest incurred by HITL was not deductible under section 16.

111. In the HIT Finance Determination the Board emphasized that HK$10,394,275,824 was only "payable forthwith … on written demand", and that no document evidencing such written demand on HITL was produced. But it does not follow that because no demand was made, there was no payment, or that any payment made was made gratuitously. It, therefore, has no significance or relevance.

112. Mr Goldberg submitted that when the Board referred to "no real money", they were referring to money which served no commercial purpose. He also submitted that HITL might have incurred the debt but had not borrowed any money. By incurring of debt, Mr Goldberg presumably referred to the debt arising out of the purchase of the Port from HIT Holdings. However, legally and as a matter of commercial reality, that debt was discharged on 28 November 1994 by payment, although payment was only possible through the loan made by HIT Finance to HITL on the same day. I believe it to be unreal to proceed on the basis that there was a debt in relation to $10,394,275,824 (US$1,345,833,493.97) payable under the Port Purchase Agreement on demand, and only the difference between US$1,345,833,493.97 and US$1,148,000,000 (the amount of the Strategic Notes), had been paid.

113. The Board in its decision regarding HIT Finance recorded that Mr Goldberg "expressly disavowed reliance on any doctrine of fiscal nullity". para. 89.

114. Since section 16 or *Ramsay* was not relied on in HITL's Case, presumably there was no reliance on any doctrine of fiscal nullity.

115. Since HITL's obligation to pay for the Port existed in the real world, its payment of the purchase price also existed in the real world. So too, its obligation to pay interest to HIT

Finance. I do not believe it can be said that had HITL been sued on HITL's guarantee or by HIT Finance on the loan, HITL had any defence. I do not believe one can disregard transactions which are commercially and legally real even if they were entered into solely or dominantly for tax reasons.

116. *MacNiven v Westmoreland Investments Limited* [2001] UKHL 6 is in point. There the House of Lords was concerned with a provision similar in effect to section 16 and the issue before the House was whether certain payments of interest were "charges on income" within the meaning of section 338 of the Income and Corporation Taxes Act 1988 which was defined to include payments of interest. There the holding company of the taxpayer lent money to the taxpayer at interest to enable the taxpayer to pay arrears of interest on loans previously made to the taxpayer by the holding company.

117. What Lord Hoffmann said under the rubric of "concept of payment" is illuminating:

> "But what is the commercial concept of a payment of a debt which treats as irrelevant the fact that the debt has been discharged? (Counsel for the Revenue) does not contend that payment must involve a negative cash flow which is not compensated by a cash flow in the opposition direction. He accepts, for example, that many commercial refinancing operations discharge old debts and create new ones without any cash flow either way." para. 67 at 258.

118. But there as here:

> "What the [Revenue] finds objectionable is the circularity of the cash flow combined with the fact that the transaction took place entirely for tax purposes." para. 68.

119. In *MacNiven* the payment of interest was held to be deductible under section 338.

120. If there had been a borrowing, and that the money borrowed was paid for the acquisition of the Port, I do not believe it is possible to say under section 16 that the borrowing was not made for the purpose of producing profits from the Port.

121. I turn to consider section 61A.

> "61A. Transactions designed to avoid liability for tax
>
> (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.

(2) Where subsection (1) applies, the powers conferred upon an assessor under Part X shall be exercised by an assistant commissioner, and such assistant commissioner shall, without derogation from the powers which he may exercise under that Part, assess the liability to tax of the relevant person-

(a) as if the transaction or any part thereof had not been entered into or carried out; or

(b) in such other manner as the assistant commissioner considers appropriate to counteract the tax benefit which would otherwise be obtained.

(3) In this section-

'tax benefit' (**稅項利益**) means the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof;

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

122. In applying section 61A, Mr Goldberg submitted that there are four distinct stages:

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).

123. He submitted and I agree that each of these stages must be considered separately and in the order set out. That failure to observe the correct order may lead to error in identification of the tax benefit and an inability properly to conclude at (4). I agree that it is important to bear these separate elements in mind, and each of them has to be satisfied before section 61A can apply. However, having regard to the submissions made, I believe it will be more convenient first to consider the definition of tax benefit in section 61A. It is quite clear that if the interest deducted fell outside the definition, then section 61A cannot possibly apply.

124. Tax benefit has been defined to mean "the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof".

125. In *Europa Oil (NZ) Limited v IRC* [1976] 1 WLR 464, the Privy Council was concerned with section 108 of the Land and Income Tax Act 1954 of New Zealand. Europa Oil sought to deduct the posted prices for its supplies of oil from Gulf. However, in order that the cost to the taxpayer company should be 2.5 cents per gallon less than the posted price, Gulf arranged in

1964, to sell to Pan Eastern, a company incorporated in the Bahama Islands, and owned in equal shares by Gulf and the subsidiary of the taxpayer company, sufficient crude oil to produce the semi-refined oil required by Europa under the supply contract. That crude oil was processed by Gulf for Pan Eastern for a fee, and the semi-refined oil re-purchased by Gulf at prices which ensured that Pan Eastern made a profit equivalent to 5 cents per gallon, on the oil eventually purchased by the tax company. That arrangement resulted in half the profit earned by Pan Eastern being passed to the taxpayer, in the form of dividend on the shares in Pan Eastern. Having regard to the profit of 2.5 cents per gallon the question was whether Europa should be allowed to deduct the full posted price which it paid to Gulf. By a majority, Lord Wilberforce dissenting, the Privy Council, held that the payment by the taxpayer for the oil was deductible as having been "exclusively incurred in the production of the assessable income" under section 111 of the New Zealand legislation.

126. However, section 108 provided:

> "… 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."

127. On the question of whether under section 108, the arrangement was absolutely void, Lord Diplock said:

> "There are several things to be noted in connection with the application of this section. First, it is not a charging section; all it does is to entitle the commissioner when assessing the liability of the taxpayer to income tax to treat any contract, agreement or arrangement which falls within the description in the section as if it had never been made. Any liability of the taxpayer to pay income tax must be found elsewhere in the Act. 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. Nor does it prevent the taxpayer from parting with a source of income.

> Thirdly, the references in the section to ' the incidence of income tax' and ' liability to pay income tax' are references to New Zealand income tax. The section is not concerned with the fiscal consequences of the impugned contracts, agreements or arrangements in any other jurisdiction. In the instant case it would have made no difference if Pan Eastern, instead of being established in a tax haven, had been established in the United Kingdom and incurred liability to pay corporation tax there upon its profits under the new processing contract.
>
> Fourthly, the section in any case does not strike down transactions which do not have as their main purpose or one of their main purposes tax avoidance. It does not strike down ordinary business or commercial transactions which incidentally result in some saving of tax. There may be different ways of carrying out such transactions. They will not be struck down if the method chosen for carrying them out involves the payment of less tax than would be payable if another method was followed. In such cases the avoidance of tax will be incidental to and not the main purpose of the transaction or transactions which will be the achievement of some business or commercial object: *Newton v. Commissioner of Taxation of the Commonwealth of Australia* [1958] A.C. 450, 465; *Mangin v. Inland Revenue Commissioner* [1971] A.C. 739 and *Ashton v. Inland Revenue Commissioner* [1975] 1 W.L.R. 1615.
>
> Their Lordships' finding that the moneys paid by the taxpayer company to Europa Refining are deductible under section 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."

128. Europa was the foundation of two submissions by Mr Gardiner. First that tax benefit in section 61A should be construed in such a way that it does not apply to new sources of income. In other words "liability to tax" must be a liability from a pre-existing source.

129. Secondly, that if the interest payment is deductible under section 16 in the calculation of profits, such that any liability to tax could only have been arrived at after such deduction, it would be incompatible to regard such a deduction as a tax benefit since ex hypothesi, the deductible interest could not avoid or reduce the amount of tax payable.

130. On the first point, and as Mr Gardiner accepts, what we are concerned with is a construction of section 61A, and therefore what was said by Lord Diplock in relation to section 108 of New Zealand legislation is not directly applicable.

131. Moreover, section 61A is modelled on Part 4A of the Australian Tax legislation, and not on section 108 of the New Zealand legislation, so Australian decisions might throw more light on section 61A than decisions on New Zealand legislation.

132. In *Bunting v Federal Commissioner of Taxation*, [1989] 90 ALR 427, a decision of the Federal Court of Australia, Gummow J had this to say about the relevance of *Europa* to section 260 of the Income Tax Assessment Act 1936 [Cth] which was the predecessor of Part 4A, at 437:

> "… 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 fact 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."

133. Furthermore, Mr Goldberg submitted that whilst section 108 and section 260 had an annihilating effect on the transaction, section 61A does not have that effect.

134. If one compares the provisions in Part 4A with section 61A, one is struck with the close resemblance which section 61A(1) bears to section 177D, with the important difference (though irrelevant to this appeal) that in Hong Kong as opposed to Australia, it is not the Revenue who determines "that the person, … who entered into ... the transaction, did so for the sole or dominant purpose …". On the other hand, the definition of "tax benefit" in section 61A is sparse compared with the definition of tax benefits in section 177C.

135. Under section 177C tax benefits include:

> "(b) a deduction being allowable to the taxpayer in relation to a year of income where the whole or a part of that deduction would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer in relation to that year of income if the scheme had not been entered into or carried out;"

136. It is perhaps also worthy of note that under section 177C tax benefits also included an amount not being included in the assessable income of the taxpayer where that income would have been included, or might reasonably be expected to have been included, in the assessable income of the tax payer of that year of income if the scheme had not been entered into or carried out.

137. Under section 61A tax benefit "means the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof;"

138. There is a disagreement over whether "the amount thereof" refers to the liability to pay tax, or the amount of tax payable. It is unnecessary to resolve the difference because counsel are agreed that it makes no difference. According to Mr Gardiner, the word "liability" is in the objective genitive: if one were to replace the word "avoidance" (or "postponement") with a verb the word "liability" could be its object. The word "thereof" which means "of it" or "of that" is thus used to refer back to that object, i.e. to the liability [to pay tax]".

139. Mr Gardiner on the other hand, submitted liability is not an objective genitive, but a subject of the verb "to pay" in a sub-clause within section 61A(3).

140. I do not believe it matters whether "the amount thereof" refers to the liability or the tax payable and will not attempt to resolve the difference.

141. The key is whether a deduction of interest might result in the avoidance of the liability to pay tax or the reduction in the amount thereof.

142. Nor do I believe the applicability of section 61A depends on whether the transaction is blatant. Indeed, I believe that for the purpose of section 61A, it is unhelpful to seek to distinguish between mitigation and avoidance of tax. Lord Hoffmann said in *MacNiven* at para. 62:

> "But when the statutory provisions do not contain words like 'avoidance' or 'mitigation', I do not think that it helps to introduce them. The fact that steps taken for the avoidance of tax are acceptable or unacceptable is the conclusion at which one arrives by applying the statutory language to the facts of the case. It is not a test for deciding whether it applies or not."

143. So I would not ask whether liability to pay tax was mitigated or avoided. The definition of tax benefit in section 61A includes both avoidance and reduction. The defining feature of section 61A in this context is whether the transaction was entered into solely or dominantly for the relevant purpose. So I will look at the words of section 61A and ask whether there was a tax benefit and if so whether the other requirement of section 61A are also satisfied. If so, section 61A applies.

144. Moreover, I would note that in *Newton v Commissioner of Taxation of the Commonwealth of Australia* [1958] AC 450, dealing with section 260, Lord Denning in delivering the advice of the Board said at page 464:

> "Next, Sir Garfield Barwick submitted that in section 260 (c) the words 'liability imposed on any person' meant a liability which had already accrued: and that 'avoid' meant displace. He said that in order that an arrangement should be avoided, it must be an arrangement 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. Their Lordships cannot accept this submission. They are clearly of opinion that the word 'avoid' is 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. It is this meaning of 'avoid' which gives the clue to the meaning of 'liability imposed'. 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 Sir Garfield Barwick 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. Their Lordships notice that, although this point was not raised in the High Court, Taylor J. did consider it, and they find themselves in agreement with what he said upon it."

145. I do not agree the liability to be avoided has to be pre-existing in the sense that it came from an existing source. See *Cheung Wah-keung v Commissioner of Inland Revenue* [2002] 3 HKLRD 773 at 791, paras. 47 and 48. Instead, I would ask whether the amount of the tax payable has been reduced by the interest expense. If so, that was a tax benefit. A deduction falls within the definition of tax benefit. That conclusion is arrived at by construing the definition purposively.

146. I note that in *Peterson*, in the dissenting judgments of Lord Bingham and Lord Scott, they said at 470:

> "[88] …The obtaining of the right to make deductions from assessable income is, in ordinary language, obtaining a tax advantage."

147. This supports my view that as a matter of common sense and language, deduction of an interest expense falls within the words of the definition.

148. As I have said, section 16(2)(c) applies to the loan from HIT Finance, since the sums payable by way of interest are chargeable to tax under the Ordinance, and so far as HIT Finance is concerned, the condition in section 16(2)(f)(ii) is satisfied because the Notes were payable by HIT Finance to the holders of the Notes which are marketable in Luxembourg.

149. However, since Ordinance No. 12 of 2004, the interest would no longer be deductible because of section 16(2B) and (2C) to the extent provided by those two subsections, which briefly stated, rendered non deductible interest payable "whether directly or through any interposed person, to the borrower or to a person (other than the lender) who is connected with the

borrower" in the case of HITL because of section 16(2B) and in the case of HIT Finance because of section 16(2C).

150. Mr Gardiner submitted that to construe section 61A in such a way as to disallow the deduction of interest in this case, is an unwarranted attempt to fill a perceived gap in the legislation which was not closed until the amendments in 2004.

151. Section 16 and section 61A serve different functions. 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."

152. Under section 16 no deduction for payment of interest could be allowed unless the conditions of section 16(2) are satisfied. But the fact that deductions could be made under section 16 would not by itself render section 61A inapplicable.

153. In *Peterson*, the Privy Council was concerned with section 99 of the Income Tax Act 1976 of New Zealand, a general anti-avoidance provision, which replaced section 108, and 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.'"

154. Thus, there is no inconsistency between an interest payment being deductible under section 16 and it being caught by section 61A.

155. Mr Gardiner referred to *Taylor v MEPC Holdings Ltd* [2003] UKHL 70. There the House of Lords was concerned with section 403 of the Income and Corporation Taxes Act

1988 which defined the amounts eligible for relief from corporation tax which might be surrendered by one member of a group relief scheme (the surrendering company) to another member (the claimant company) and the question was "how one calculates the surplus over the 'profits of the period' which is available for surrender". This was governed by section 403(8):

> "The surrendering company's profits of the period shall be determined for the purposes of subsection (7) above without regard to any deduction falling to be made in respect of losses or allowances of any other period, or to expenses of management deductible only by virtue of section 75(3)." per Lord Hoffmann at para. 5.

156. In brief, the conclusion was that:

> "… allowable losses are not included in the term 'losses' in section 403(8). An allowable loss is not a relief."

157. This is not an authority that in considering a general anti-avoidance provision, such as section 61A, one must ignore expenses and outgoing which are deductible under section 16.

158. Under section 16 interest expense may be deducted if it was incurred for the purpose of producing the taxable profits provided the conditions of section 16(2) are satisfied. Otherwise, even if money was in fact borrowed and interest paid for such purpose, the interest paid would not be deductible. It has nothing to do with section 61A, and:

> "… it is inherent in [section 61A] that, but for its provisions, the impugned arrangements would meet all the specific requirements of [section 16]." see per Lord Millett in *Peterson* at para. 4.

159. Indeed section 16(2) underlies the fact that an interest expense incurred in the production of profits and which is deductible as such for the calculation of profits in accordance with generally accepted accountable principles, may, nevertheless, be disallowed as a deduction for the calculation of assessable profits under section 16.

160. So far as section 61A is concerned, which is a general anti-avoidance provision, if the sole or dominant purpose of the borrowing was to confer a tax benefit on the relevant person, the deduction might be counteracted.

161. On the other hand, section 16(2) may be even more draconian because unless its conditions are satisfied, no deduction is allowed even though no transaction solely or dominantly tax driven is involved.

162. As noted, in section 61A, tax benefit was defined expressly as including deductions.

163. Mr Goldberg referred to *Canada Trustco Mortgage Company v Canada* [2005] 259 DLR (4th) 193, where section 245(1) of the Income Tax Act defined tax benefit to mean "a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act;". In the judgment of the Supreme Court of Canada, delivered by McLachlin CJC and Major J at 202, they said:

> "5.3 Tax Benefit
>
> [18] The first step in applying the GAAR is to determine whether there is a tax benefit arising from a transaction or series of transactions of which the transaction is part.
>
> [19] 'Tax benefit' is defined in s. 245(1) as 'a reduction, avoidance or deferral of tax' or 'an increase in a refund of tax or other amount' paid under the Act. Whether a tax benefit exists is a factual determination, initially by the Minister and on review by the courts, usually the Tax Court. The magnitude of the tax benefit is not relevant at this stage of the analysis.
>
> [20] If a deduction against taxable income is claimed, the existence of a tax benefit is clear, since a deduction results in a reduction of tax. In some other instances, it may be that the existence of a tax benefit can only be established by comparison with an alternative arrangement. For example, characterization of an amount as an annuity rather than as a wage, or as a capital gain rather than as business income, will result in differential tax treatment. In such cases, the existence of a tax benefit might only be established upon a comparison between alternative arrangements. In all cases, it must be determined whether the taxpayer reduced, avoided or deferred tax payable under the Act."

164. Mr Gardiner, however, pointed to section 245(5) which provided:

> "(5) [Determination of tax consequences] Without restricting the generality of subsection (2),
>
> (a) any deduction in computing income, taxable income, taxable income earned in Canada or tax payable or any part thereof may be allowed or disallowed in whole or in part,
>
> (b) any such deduction, any income, loss or other amount or part thereof may be allocated to any person,

> (c) the nature of any payment or other amount may be recharacterized, and
>
> (d) the tax effects that would otherwise result from the application of other provisions of this Act may be ignored,
>
> in determining the tax consequences to a person as is reasonable in the circumstances in order to deny a tax benefit that would, but for this section, result, directly or indirectly, from an avoidance transaction."

and submitted that the dictum quoted above might be the result of this provision.

165. I do not believe that to be so. But whether it is so or not, I do not believe, it matters. As Lord Bingham and Scott said in *Peterson*, in ordinary language, a deduction would be regarded as a tax benefit.

166. The issue before us, is whether on a purposive construction of section 61A, in particular, "the avoidance … of the liability or the reduction in the amount thereof;" included a deduction of interest expense under section 16. Furthermore, whether, when the facts are viewed realistically, the deduction in this case, amounted to a tax benefit. In my opinion, the answer must be yes to both questions.

167. Indeed, Mr Goldberg submitted that the definition of tax benefit covers any allowable deductions under section 16. I agree.

168. 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.'

169. ' 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;".

170. 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. Thus, 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.

171. 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).

172. 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.

173. 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.

174. 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."

175. 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."

176. 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.

177. I turn to consider the other provision of section 61A and the four stages identified by Mr Goldberg.

178. What was the transaction? Since 61A does not require the transaction to be nullified, but it permits the Revenue to assess the liability to tax:

> "as if any part thereof had not been entered into or carried out; or
>
> (b) in such manner as … to counteract the tax benefit …"

179. It is unimportant whether the transaction is the wide and narrower transaction respectively identified by the Board in para. 75(b) and (c) of its Decision. The narrower transaction essentially consists of the circular payments. However, for the purpose of this judgment, I regard the narrower transaction as the transaction.

180. I believe the *effect* of the transaction was to confer the tax benefit on HITL.

181. The relevant person is HITL.

182. The 4th stage is, whether having regard to the seven matters mentioned in section 61A, one of the actors in the transaction has a sole or dominant purpose of enabling the taxpayer to obtain the tax benefit.

183. The Board regarded all the participants in the transaction to have that as their sole or dominant purpose.

184. However, having regard to the fact that the Board's attention was diverted to the concept of "no real money", I do not believe it is fair that its conclusion on this should be allowed to stand. However, I cannot agree with Mr Gardiner's submission that on the facts, the only possible conclusion is that none of the actors in the transaction had that as its sole or dominant purpose. I would send the matter back to the Board for determination. This is a 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.

185. I can take HITL's Case from the Board's summary of Mr Pearson's evidence. Mr Pearson was the Deputy Managing Director of HIT Holdings between March 1992 and June 1996:

> "(a) The transfer of the Port from HIT Holdings to a wholly owned subsidiary was to enable the HIT Group to realize significant inherent value and to bring in new funds that could be used to finance the HIT Group's plans to expand in Hong Kong and internationally. Without the transfer of the assets to a new company for the payment partially in cash the HIT Group could not have created the pool of profits to be paid by way of dividend and used for expansion in the PRC and elsewhere.

(b) The original intention was to raise the full amount of US$1,735,000,000. This was the estimate of the then management of HIT Holdings as to the funding which the HIT Group would require over the following 8 years. He attended a meeting before August 1994 ' where the Paribas people made it clear to us they could handle this whole thing and sell the lot' . Due to the state of the then market conditions, the lead bank for the Note issue failed to deliver what they had originally indicated they could deliver. Strategic was forced to take up a substantial part of the issue.

(c) He was responsible for the proposal that was placed before the Board of HIT Holdings on 2nd September, 1994. He accepted that the proposal sought to achieve the following objectives :

(i) To make HIT Holdings a subsidiary of HIT Investments by value shifting arrangements.

(ii) To separate the operational activity of the group from its investment activity.

(iii) To separate the deep water ports from the river ports.

(iv) To separate the Hong Kong assets, operations and management from the China assets, operations and management.

(v) To raise finance so as to remove the difficulties of funding PRC projects and to meet the need for development capital in the group.

(d) There was no reference in the proposal to any dividend to be declared by HIT Holdings in favour of HIT Investments nor to any advance by HIT Investments to Strategic. He did not regard the proposal misleading by virtue of such omissions. He said the shareholders and directors of HIT Holdings knew about the arrangement through meetings. They were told before 2nd September, 1994 as to what was going to happen on 28th November, 1994.

(e) Tax was not a matter discussed at the 2nd September, 1994 meeting. He himself did not take any tax advice. There were lawyers and accountants in-house and he left it to them to look at the taxation issue. He himself did not come up with the idea of the dividend. It was the suggestion of the accounting team and the lawyers in-house. He said there was no point in leaving the dividend in HIT Holdings and they needed cash in Strategic."

186. The Board made the following important observations:

> "We believe the problem is more fundamental. 4 important aspects of this appeal received little or inadequate treatment in the evidence.
>
> (a) First, the initial intention was to raise externally the totality of the funds required. The 31st August, 1994 letter from Banque Paribas made it clear that a member of the HIT Group had to purchase up to US$ equivalent of HK$9,200,000,000 of a HK$13,400,000,000 issue. The initial intention was clearly frustrated. We would have expected discussions being held to consider this issue and the factors for pressing ahead being debated extensively. No such evidence has been placed before us.
>
> (b) Secondly, a member of the HIT Group was committed to take up Notes in an aggregate amount up to US$ equivalent of HK$9,200,000,000. Where would that money come from? It was not a problem of PAL or Banque Paribas. It was a problem of the HIT Group. We do not regard this as a matter of details. The raising of this amount must have received the attention of the senior management. Had this issue been delegated to a subordinate, the senior management must have been fully briefed on the solution offered. It is not a proper discharge of the onus of proof to take shelter behind the delegation and offer no evidence on the nature, the planning and the execution of the solution.
>
> (c) Thirdly, the declaration of dividend by HIT Holdings and the loan from HIT Investments to Strategic were not considered at the Board meeting of HIT Holdings on 2nd September, 1994. The author of these steps had not been identified. There is no direct evidence on the considerations that prompted the author to devise these steps as part of the re-structuring."

187. Having regard to these observations, I would hesitate to regard the narration of HITL's Case or evidence as necessarily findings of fact by the Board for the purpose of deciding sole and dominant propose.

188. Because of the order in which the appeals were argued before the Board, the Board dealt first with HIT Finance's appeal and then incorporated the bulk of their decision in HIT Finance's appeal into their decision on HITL's appeal. That being the case, the questions raised in HITL's Case, have to be read in the light of the questions raised in HIT Finance's Case. These questions can be seen in my judgment in HIT Finance's appeal and will not be repeated here.

189. Underlying the HIT Finance's Case is the question whether the Board's conclusion that "no real money was raised by the Strategic Notes", such that it followed that HITL never

borrowed the proceeds of the Strategic Notes from HIT Finance, nor paid HIT Holdings the same in part payment of Port was correct.

190. Having regard to my view that this part of the Board's finding is unsupportable as a matter of law, I believe the proper order to make is to send the matter back to the Board so that they can reconsider their decision on section 61A on the basis that HITL had borrowed the proceeds of the Strategic Notes from HIT Finance, paid the same to HIT Holdings in part payment for Port and interest to HIT Finance for the same. In particular, whether the transaction was entered into or carried out for the sole and dominant purpose of enabling HITL, either alone or in conjunction with other persons, to obtain a tax benefit.

191. I turn now to consider section 61.

192. The only basis upon which the Board concluded that the transaction was artificial or fictitious was that "no capital sum was involved;" which I believe, was another way of saying there was no real money. So for the same reasons I have given under section 61A, that conclusion cannot be supported.

193. The questions raised in the case stated are:

> "(A) In relation, in particular, to Section 61A of the IRO:
>
> (1) whether, in the light of the Court's holding in relation to question (A)(1) in the Case Stated of HIT Finance and the facts otherwise found by us, HITL obtained a 'tax benefit' as defined by Section 61A.
>
> (2) whether it was open to us to identify a transaction as being the borrowing of money by HITL from HIT Finance and then to disregard or exclude the same under Section 61A (and Section 61) whilst leaving HITL in the position of having acquired the Port on the terms on which it, in fact, did so.
>
> (3) whether, on the facts found by us and in the light of the Court's holding in relation to (A)(1) above, it was open to us to conclude, having regard to the seven factors set out in Section 61A(1) that the sole or dominant purpose was to obtain a 'tax benefit' (as defined) for HITL.
>
> (B) In relation, in particular, to Section 61 of the IRO:
>
> (4) whether, on the facts found by us and in the light of the Court's holding in relation to (A)(1) above, there was any transaction which reduced or

would reduce the amount of tax payable by HITL as required by Section 61.

(5) whether, the true and only reasonable conclusion is contrary to that found by us as follows:

'HITL did not in fact borrow money from HIT Finance to the extent of US$1,148,000,000. The alleged borrowing was merely part of the façade to secure an interest deduction'. (Paragraph 7 of the Decision)

(C) Generally:

(6) whether, on the facts found by us and in the light of the Court's holding in relation to (A)(1) above, there were any grounds in law for dismissing the appeals and upholding and increasing the assessments.

(7) whether, having found that Sections 61A and 61 applied in the case of HIT Finance, so as to charge that company to tax on the sums shown in its computations as interest paid to it by HITL, it was open to us, on the basis of the same facts and reasoning, to find that they also applied in the case of HITL so as to exclude or limit its deduction for the same sums shown in its computation as paid by it as interest; and especially so having regard to the fact that all assessments on HITL have been raised in the alternative to those on HIT Finance."

The answer to A(1)

194. The answer to A(1) in HIT Finance's Case is that in relation to the statement that "no real money was raised by the Strategic Notes", the true and only reasonable conclusion is contrary to that as found by the Board. However, the deduction of interest on a bona fide loan could nevertheless be a tax benefit. So on that basis the answer is yes.

The answer to A(2)

195. Insofar as the transaction was disregarded as having involved no real money, the answer is no.

The answer to A(3)

196. No, insofar as a critical fact found by the Board was that no real money was involved in the Strategic Notes.

197. The answer to B(4), is predicated on the finding that there was no real money. Since I am of the view that the finding is incorrect, it is meaningless to answer this question.

198. The answer to B(5), yes.

199. The answer to C(6), no.

The answer to C(7)

200. As I have said, I believe logically, HITL' s assessment should be considered first. If it is decided that the transaction was entered into for the sole and dominant purpose of conferring a tax benefit on HITL, and that HIT Finance played a part in such sole and dominant purpose, then as a question of fact, it may be difficult not also to arrive at the conclusion that the sole and dominant purpose in relation to HIT Finance was also to confer a tax benefit. But theoretically, that is possible. Moreover, should the conclusion on the facts be, that the transactions involving both HITL and HIT Finance were caught by section 61A, the Revenue should consider under section 61A(2)(b), what measures might be appropriate to counteract the tax benefit which would otherwise be obtained. It may be that it would not be a permissible exercise of discretion "to exclude or limit its deduction for the same sums". However, since the conclusions on section 61A and 61 are not supportable, I would prefer to hold that the question in this form does not arise for determination and I do not determine it.

HIT Finance' s appeal

201. For the reasons given above, I would also remit this matter to the Board for determination.

202. The questions raised in HIT Finance' s case stated are:

> "(A) In relation to the *Ramsay* principle and Section 16 of the IRO:
>
> (1) whether in relation to the statement that ' no real money was raised by the Strategic Notes' (paragraph 90 of the Decision and similar statements at paragraphs 71 and 72) the true and only reasonable conclusion is contrary to that as found by us.
>
> (2) whether, in the light of the Court' s holding in relation to question (A)(1) above and the facts otherwise found by us, it was open to us to conclude that the deduction sought by HIT Finance for interest on Notes held by Strategic was not within the ambit of the section as:

'No real money was raised by the Strategic Notes. As there was no capital sum, no interest was payable. The 'interest' was not incurred in the production of profit. The 'interest' was merely part of a façade to achieve a tax deduction' (paragraph 90 of the Decision).

(B) In relation, in particular, to Section 61A of the IRO:

(3) whether on the facts found by us and in the light of the Court's holding in relation to question (A)(1) above, HIT Finance obtained a 'tax benefit' as defined by Section 61A.

(4) whether, on the facts found by us and in the light of the Court's holding in relation to question (A)(1) above, it was open to us to conclude, having regard to the seven factors set out in Section 61A(1) that the sole or dominant purpose was to obtain a 'tax benefit' (as defined) for HIT Finance.

(C) In relation, in particular, to Section 61 of the IRO:

(5) whether, on the facts found by us and in the light of the Court's holding in relation to question (A)(1) above, there was any transaction which reduced or would reduce the amount of tax payable by HIT Finance as required by Section 61.

(6) whether, on the facts found by us and in the light of the Court's holding in relation to question (A)(1) above, it was open to us to conclude that the 'Strategic Notes are both artificial and fictitious'.

(D) Generally:

(7) whether it is permissible, in applying Section 61A. Section 61 or the *Ramsay* principle and Section 16 to the facts of this case, to exclude the deduction for tax purposes of interest shown as payable by the taxpayer in its computations, whilst leaving the income shown as arising in the taxpayer's computations assessable to profits tax without a deduction for all the interest so shown.

(8) whether, on the facts found by us and in the light of the Court's holding in relation to question (A)(1) above and the law determined by us or the law that should have been determined, there were any grounds in law for dismissing the appeals and upholding and increasing the assessments."

203. I will answer them as follows:

(A)(1) Yes.

(A)(2) No.

(B)(3) HIT Finance obtained a tax benefit but not for the reasons given by the Board.

(B)(4) The Board should reconsider having regard to the court' s holding in relation to question (A)(1) above, whether, having regard to the seven factors set out in section 61A(1), the sole or dominant purpose was to obtain a ' tax benefit' (as defined) for HIT Finance.

(C)(5) See answers to (A)(1) and (A)(2) above. No.

(C)(6) See answers to (A)(1) and (A)(2) above. No.

(D)(7) Since the factual basis, namely, that "no real money was raised by the Strategic Notes" is not sustainable, this question does not arise.

(D)(8) The question does not arise because of the answers to (A)(1) and (A)(2) above.

Hon Le Pichon JA:

204. These are appeals by HIT Finance Ltd ("HIT Finance") and Hong Kong International Terminals Ltd ("HITL") directly from the Board of Review pursuant to leave granted under section 69A of the Inland Revenue Ordinance.

205. In the case of HIT Finance the Commissioner of Inland Revenue ("the Commissioner") confirmed tax assessments for profits tax and additional profits tax that had been raised by the Assistant Commissioner in January 2000 ("the assessments") totalling, in very round terms, HK$511 million. In the case of HITL, the assessments had been raised by the Assistant Commissioner in March 2002 as "alternative assessments" to bring into charge the interest paid to HIT Finance. The Commissioner dismissed HITL' s appeal but revised the alternative assessments down from HK$895 million to HK$498 million.

206. The Board dismissed the appeals by HIT Finance and HITL from the Determinations of the Commissioner dated 30 May 2003 but increased the assessments and alternative assessments to the figures outlined in letters from the Department of Justice dated 26 November

2004 to the solicitors for each of the taxpayers. As I have not been able to locate those letters in the hearing bundles the increases are not known but, on any view, the amount of tax in issue is substantial.

207. It was on HIT Finance that the Revenue had focussed its case from inception. The assessments on HIT Finance of January 2000 had been raised on the basis of section 61A. Likewise the alternative assessments subsequently raised on HITL. The assessments and alternative assessments sought to disallow deductions of interest attributable to the Strategic Notes so as to counteract the tax benefit the Revenue considered had been obtained. Both before the Board and in this court, the lead or main case was the HIT Finance appeal.

Background facts

208. Hutchison Whampoa Ltd, the well-known conglomerate, has extensive port interests worldwide. These are held through subsidiary companies including Hutchison International Port Holdings Ltd ("Port Holdings") and one of its indirectly held subsidiaries HIT Holdings Ltd ("HIT Holdings") was owned as to 22.5% by outside corporate shareholders prior to November 1994. By early 1994, HIT Holdings considered that there was a very real need to raise substantial funds from the market to meet projected capital expenditure requirements for the expansion of its port interests in Hong Kong as well as in China. The amount initially contemplated was US$1.78 billion. As part of the same exercise, there was to be a corporate reorganisation to rationalise and streamline its operations. HIT Holdings' interests at Kwai Chung Container Port Terminals 4, 6 and 7 ("the Port") were valued at HK$23 billion in May 1994.

209. In early August 1994 Banque Paribas ("Paribas") had been confident in raising from the market US$1.735 billion (equivalent to HK$13.4 billion) through a guaranteed US$ Floating Rate Note issue ("FRN issue") to be listed on the Luxembourg Stock Exchange for HIT Finance (a wholly owned subsidiary of HIT Holdings) as Issuer. But the market turned and by 31 August 1994, whilst it was prepared to form a syndicate to fully underwrite the issue, Paribas itself would underwrite up to the US dollar equivalent of HK$1.05 billion only. Moreover, it required a 100% guarantee by HITL and, *inter alia*, a collateral undertaking by Port Holdings that a member of the HIT Group would subscribe for or purchase for its own account FRNs ("the Notes") up to the US dollar equivalent of HK$9.2 billion. Port Holdings agreed to those conditions on 9 September 1994.

210. Meanwhile, at a board meeting held on 2 September 1994, HIT Holdings approved a proposal ("the September proposal") which involved a corporate restructuring, the sale of the Port by HIT Holdings to HITL at its market value of HK$23 billion, the incorporation of a wholly owned subsidiary (HIT Finance) to act as borrower for HITL through the FRN issue to raise HK$13.4 billion to be on lent to HITL with interest to finance the Port purchase.

211. In paragraph 70 (a) of its Decision in HIT Finance, the Board observed that "[t]he initial intention was clearly frustrated". So instead of raising, externally, the entirety of the funding required, effectively, because of the take-up commitment, up to 68% had to come from within the Group itself. Despite this fundamental change in circumstance, the September proposal went ahead but no evidence was adduced as to the factors for pressing ahead or where the money to meet the commitment would be coming from. The Board commented adversely on the inadequacy of the evidence, *inter alia*, in those respects.

212. The formal documentation for the issue of the Notes by HIT Finance was signed on 23 November 1994. The Listing Memorandum and the Subscription Agreement showed that the proceeds of the issue of the Notes (less expenses) would be lent by HIT Finance to HITL for the purchase of the Port from HIT Holdings, that Paribas Asia Ltd ("PAL") as manager would subscribe and pay for US$1.208 billion of the Notes and that it had also agreed to sell to Strategic, a company owned by the same group of shareholders that indirectly owned the Issuer and the Guarantors, approximately US$1.148 billion in principal amount of the Notes subscribed for by PAL. The interest rate payable on the Notes was 0.85% above six-month LIBOR.

213. After the September board meeting, certain steps were taken in anticipation of and to facilitate the events that were to occur on 28 November 1994, notably, the acquisition by HIT Investments Ltd ("HIT Investments"), the immediate holding company of HIT Holdings, of all the shares in HIT Holdings, resolutions (a) by HIT Holdings not only to sell the Port to HITL for HK$23 billion but also to declare a dividend of HK$9.7 billion (equivalent to US$1.256 billion) from the proceeds of sale; (b) by HIT Investments that upon receiving a dividend of HK$9.7 billion, it would lend that amount interest-free to Strategic by way of a loan note for investment purposes; (c) by Strategic that it would undertake treasury functions for HIT Investments including the subscription in the FRNs to be issued by HIT Finance of an aggregate of US$1.148 billion. The Board noted that the dividend declaration by HIT Holdings and the interest-free loan to Strategic did not form part of the September proposal and commented adversely on the absence of direct evidence on the considerations that prompted the need for and the adoption of these additional steps as part of the restructuring.

214. Various events then occurred on 28 November 1994:

(1) HIT Holdings entered into an agreement ("the Port Purchase Agreement") to sell the Port to a newly formed subsidiary, (i.e. HITL) for HK$23 billion, approximately HK$10.394 billion of which was payable in cash upon written demand from HIT Holdings, HK$6.1 billion by way of an interest-free subordinated loan note and the balance of approximately HK$6.5 billion as a back-to-back loan.

(2) HIT Finance signed a loan note with HITL for an advance to HITL of US$1.735 billion with interest at 1% per annum above LIBOR.

(3) HIT Holdings declared a dividend of HK$9.7 billion (equivalent to US$1.256 billion) from the proceeds of sale of the Port.

(4) HIT Investments lent Strategic the same amount i.e. US$1.256 billion, interest-free.

(5) Strategic purchased US$1.148 billion of the Notes ("the Strategic Notes") from PAL.

215. So on 28 November 1994, a circular transaction came about: money moved from (1) PAL to HIT Finance (proceeds of the Notes); (2) HIT Finance to HITL (loan of the proceeds); (3) HITL to HIT Holdings (cash consideration for the Port purchase); (4) HIT Holdings to HIT Investments (payment of dividend); (5) HIT Investments to Strategic (interest-free loan); (6) Strategic to PAL (cash consideration for the Strategic Notes).

216. Strategic disposed of about 18% of the Strategic Notes between 1995 and 1997. Meanwhile, in January 1996, Strategic was given the right by HIT Investments to repay the outstanding loan at any time. That it did after it had disposed of the balance of the Strategic Notes by July 2001 to outside parties.

217. In August 2001, HITL borrowed US$1.131 billion from Hutchison International Ltd at a better interest rate and repaid HIT Finance its outstanding loan. HIT Finance then redeemed all the outstanding Notes in November 2001.

218. As noted above, in January 2000, the Assistant Commissioner had raised the assessments on HIT Finance invoking section 61A and in March 2002, he had raised alternative assessments on HITL. As appears from the Determinations, the Commissioner's conclusion in both appeals was that HIT Investment, HIT Holdings, HIT Finance, HITL, Strategic and PAL had carried out the various steps in connection with the issue and subscription of the Strategic Notes for the sole or dominant purpose of obtaining a tax benefit. She was also of the view that interest relating to the Strategic Notes was not deductible under section 16 on the basis that in substance no money had been borrowed in respect of the Strategic Notes, the borrowing being in substance covered by advances from HIT Investments and that HITL could have achieved the same end result without the issue of the Strategic Notes. But it is to be noted that the Commissioner agreed with the Assistant Commissioner that the assessments on HIT Finance and HITL were in the alternative with the necessary consequence that only one set of interest deductions on the Strategic Notes should be disallowed.

219. The logic behind the Assistant Commissioner's approach of focusing on the deductions sought by HIT Finance and the raising of assessments in the alternative on HITL is not readily discernible. On further consideration, it would appear that the perceived tax benefit the

Revenue sought to counteract was this. HITL's profits that would otherwise have been chargeable to tax had been reduced by an amount corresponding to the interest it had to pay on the loan from HIT Finance that was attributable to the Strategic Notes. As 15% of that amount (being the interest differential between the interest payable on the Strategic Notes by HITL and HIT Finance respectively) had already been brought within the tax net as taxable profits of HIT Finance, it was thus only the balance i.e. 85% that had not attracted tax. That of course corresponded to the amount of interest paid to Strategic on the Strategic Notes by HIT Finance. If allowable as a business expense of HIT Finance, it would not constitute profits of HIT Finance chargeable to tax. Nor would such interest when paid to Strategic on the Strategic Notes by HIT Finance: being offshore interest, it would not be taxable as profits in the hands of Strategic. Put shortly, the perceived tax benefit was 85% of the interest payments made on the Strategic Notes by HITL which would otherwise have been chargeable to profits tax but which had been transformed into tax-free income in the hands of Strategic, a member of the HIT Group.

220. It was that perceived tax benefit that the Commissioner (agreeing with the Assistant Commissioner) sought to counteract. She did so by disallowing the interest deductions sought by HIT Finance on the interest so paid to Strategic. As appears from paragraph 3 (1) of the HITL Determination, the Commissioner clearly did not consider it appropriate or necessary, for the purpose of counteracting the perceived benefit, also to disallow the deduction of interest payments on the Strategic Notes by HITL. This may explain why the focus had been on HIT Finance.

221. On that analysis, it would have been more logical to have focussed on HITL and the interest it had paid on the Strategic Notes rather than on HIT Finance which was but a conduit in the scheme of things. Given the wide powers conferred on the Revenue by section 61A(2)(b) to counteract the tax benefit, the desired result could easily have been achieved through an adjustment to reflect the tax already paid by HIT Finance on the interest differential mentioned above.

222. I pause here to remark that neither party addressed the court on the status of "alternative assessments". I note that no reference to "alternative assessments" can be found in the Ordinance. More particularly, it is unclear whether, in dismissing the appeal from the Commissioner in HITL's case, it was open to the Board to convert what had been alternative assessments into assessments the effect of which is to disallow both sets of interest payments on the Strategic Notes which it appeared to have done.

These appeals

The "no real money" issue

223. In paragraph 90 of its Decision in the HIT Finance appeal, the Board stated that "[n]o real money was raised by the Strategic Notes". This echoed the Board's earlier conclusions (at paragraphs 71, 72 and 77 (c) (ii), (d) (ii) and (f) (ii) of its Decision in that appeal) that:

- "[t]he issue of the Strategic Notes did not actually produce any money for HIT Holdings' business";

- "[t]he only real money raised was the sum of US$587,000,000 in respect of Notes subscribed by the independent financial institutions";

- "in substance no money at all was raised on 28th of November, 1994 on the basis of the Strategic Notes";

- "[n]o real money at all was or could be raised by the HIT Group on 28th of November, 1994 on the basis of the Strategic Notes"; and

- "HIT Finance had undertaken liabilities in respect of the Strategic Notes although in substance it did not raise any money by the issue".

224. It is evident from the background facts set out above that the original intention of the restructuring which was to raise much needed financing from the market had been "frustrated" because of market conditions; yet, the September proposal proceeded apace. As noted above, the Board found the evidence wanting as to the reasons for proceeding and, indeed, where some 66% of the needed financing was to come under Paribas's revised proposals. It was plainly exercised by the taxpayers' reasons for going ahead. This led the Board to reject HIT Finance's case that "the transaction gave funding and the source of funding that the HIT Group required to fund its expenditure requirements". The Board found (at paragraph 77 (b) (ii)) that "the transaction did not fulfil such grand purpose." The Board was also troubled by the lack of explanation for the insertion into the September proposal of two additional steps, namely, the declaration of a dividend of HK $9.7 billion in favour of HIT Investments and the making of an interest-free loan by HIT Investments of the same amount to Strategic. This led the Board to conclude that there was no commercial justification for the declaration of the dividend in favour of HIT Investments and the loan to Strategic.

225. In paragraph 72 of the HIT Finance Decision, where the Board said that "the only real money raised" was the US$587 million of the Notes subscribed by independent financial institutions and that this was "hard cash raised", it appeared to draw a distinction between funds raised externally (which had been the *raison d'etre* of the exercise) with what had to come from within the Group (whether from funds which the Group already had or could realize through the sale of the Port) and in that sense did not appear to the Board to be "real money". I pause here to observe that inter-Group loans would nonetheless involve "money". Given that context, I had considered whether, fairly read as a whole, references by the Board to "real money" merely meant money raised from the market as opposed to money raised internally which, not being outside funding, was not considered to be "real money" but (with some diffidence) had to conclude that it could not be so read. Whilst many of the conclusions would be consistent with such a reading, there is the difficulty that paragraph 71 (quoted in full by Rogers VP in paragraph 11 of his

judgment) does not sit comfortably with such a reading. Then in paragraph 83 the Board stated categorically that:

> "… there never was a borrowing of US$1,148,000,000 on the basis of the Strategic Notes. No real money ever changed hands. The Strategic Notes are both artificial and fictitious."

This was followed in paragraph 90 by:

> "No real money was raised by the Strategic Notes. As there was no capital sum, no interest was payable… The "interest" was merely part of a facade to achieve a tax deduction."

226. I now turn to consider is whether the Board's conclusion that "no real money was raised by the Strategic Notes" is sustainable. That the Notes were issued on the Luxembourg Stock Exchange and that the Strategic Notes formed part of that issue are undeniable facts. To say that only the balance of the Notes (i.e. the Notes less the Strategic Notes) were actually issued flies in the face of reality. The Strategic Notes have been sold on the market and notwithstanding the Board's statement at paragraph 83 of its Decision quoted above, there is no evidential basis upon which it could be said that they were "artificial and fictitious". It is one thing for the Board to conclude that there was no commercial justification in the declaration of dividend in favour of HIT Investments and the interest-free loan made to Strategic, it is quite another to a conclude that the Strategic Notes were "artificial and fictitious" because such a conclusion did not necessarily follow.

227. The fact that the funding was internal did not make the funds any the less real. The Notes could not have been issued without producing funds for the Issuer in accordance with the listing documentation. In this regard, there is little I can usefully add to the reasons given in paragraphs 21 to 24 of the judgment of Rogers VP with which I agree.

Section 16

228. This conclusion of "no real money" resulted in the Board disallowing the deduction of interest paid by HIT Finance on the Strategic Notes under section 16 of the Ordinance. The basis was that no interest could have been paid because no capital had been raised by the Strategic Notes. Since that premise is unsustainable, it would follow that the disallowance is also unsustainable.

229. It is to be noted that the Case Stated in HITL did not raise any question relating to the deductibility of interest paid by HITL to HIT Finance attributable to the Strategic Notes under section 16. This may be explained by the fact that the Revenue did not rely on it whether before the Commissioner or the Board. But Mr Goldberg SC did argue HITL's appeal on the basis that HITL could not have deducted the interest payable on the Strategic Notes under section 16. It was

said that "no real money" did not necessarily mean no money and even if money had been put into the circle, it did not perform any commercial purpose other than to justify book entries and served no function except to assist in creating a deduction. He further submitted that HITL did not pay for the Port as part of its commercial operations in order to earn profits. Rather, it was said that it replaced internal funding which was interest-free by an interest bearing debt. So it was submitted that the "purpose" of the borrowing was not for the production of profits as required by section 16(1)(a).

230. However, the only relevant finding made by the Board was that there never was a borrowing on the basis of the Strategic Notes. As that conclusion is unsustainable, in my view, there is no proper basis for disallowing the deduction.

Section 61A

231. Proceeding, as I must, that the interest expense under the Strategic Notes is deductible under section 16, the questions which then arise are whether such an expense 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.

232. The first of those questions arose for determination in the recent decision of this court in *Commissioner of Inland Revenue v Tai Hing Cotton Mill (Development) Ltd*, unreported, CACV 343 of 2005 (22 December 2006). In the present case, Mr Gardiner QC, like Mr Flesch QC in the *Tai Hing* case, sought to argue that a deduction under section 16 is precluded from being a tax benefit for the purposes of section 61A.

233. Reference should be made to paragraphs 69 to 82 of my judgment in the *Tai Hing* case where I had considered that question. I do not propose to repeat what I said there in this judgment but would only add the following observations. In the Ordinance, "tax benefit" is defined as meaning "the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof". As explained in the *Tai Hing* case, in my view, "liability" in section 61A(3) is not confined to an existing or accrued liability and is to be construed as extending to and including a potential liability to tax. As I understand it, Mr Gardiner does not take a different position. He referred to a set off of losses under section 19C(4) of the Ordinance as the classic example of a deduction which would reduce the liability to tax but it was part of his submission that a reduction could also operate in cases where there is a potential liability to tax. Mr Gardiner QC postulated the following example: a person acquires a port which may or may not make a profit but because he thought it might, he enters into a transaction that throws up a loss which he then sets against profits if they should accrue. It was said that these were circumstances that give rise to a potential liability and the purpose of entering into the transaction was to defeat that potential liability.

234. On the question of "reductions", in *Petersen v Commissioner of Inland Revenue* (2005) STC 448, Lord Millett (delivering the majority judgment of the Board) considered that a

depreciation allowance which reduced the taxpayer's liability to pay tax was a tax advantage. On this issue, the court was unanimous. See [34] and [93] of the judgment. If I have not misunderstood Mr Gardiner, he appeared to draw a distinction between deductions made against assessable profits which he accepted would amount to the obtaining of a tax advantage or tax benefit and deductions that would reduce the amount of profits chargeable to tax (and consequently the ultimate tax liability of the taxpayer) which would not. In my view, there is no distinction of substance between the making of deductions from assessable income and the making of deductions from profits in order to arrive at the amount of assessable income. In the former case, the liability to tax is reduced and in the latter, the potential liability to tax is reduced.

235. In paragraph 82 of the *Tai Hing* judgment I reached the conclusion that:

> "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."

I remain of that view. It would follow that an interest expense in respect of the Strategic Notes that is deductible under section 16 is capable of being a tax benefit for the purposes of section 61A.

236. On the question whether the deduction of interest payable on the Strategic Notes was a tax benefit for the purposes of section 61A, since a tax benefit cannot be determined *in vacuo*, the answer would depend on the "transaction" in question. Before the Board, Mr Goldberg QC had identified no fewer than three variations or versions of the transaction. See paragraph 75 (b) to (d) of the HIT Finance Decision. In my view, such an approach was not particularly helpful.

237. For the purposes of section 61A, it is necessary to focus on the "transaction" identified as well as "the relevant person". On the basis that the transaction was that set out in paragraph 75(c) of the HIT Finance Decision and the relevant person HITL, the interest deductions on the Strategic Notes by HITL would be a tax benefit. On that analysis, HIT Finance's role would be a mere conduit and has no separate or independent significance.

238. There remains then the question of whether the sole or dominant purpose was to obtain the tax benefit having regard to the seven factors set out in section 61A(1). That is a finding of fact that is for the Board and not for this court to make. The difficulty that presents itself is that the Board's finding concerning the sole or dominant purpose was premised on there being "no real money". As the premise is unsustainable, that finding that it was the sole or dominant purpose itself must be put in question.

239. In those circumstances, what are the options open to this court? In *Commissioner for Inland Revenue v Hang Seng Bank Ltd* 2 HKTC 614 at 638. Cons VP considered that this court "may remit to the Board with [the court's] opinion thereon". That is all very well but it is not entirely clear what that would achieve given that the constraints of the case stated procedure mean that it is now too late for further findings to be made. Indeed, this court has no jurisdiction under the case stated procedure to remit the matter to the Board to reconsider their findings. See *Yau Wah Yau v Commissioner for Inland Revenue*, unreported, CACV 97/2006, 8 December 2006. Regrettably these matters were not dealt with at the hearing. For my part, I would welcome further assistance from counsel (by way of written submissions) on this question, not least because that may have a bearing on the answers to some of the questions posed.

Section 61

240. As explained above, the Board's conclusion that the Strategic Notes were "artificial and fictitious" is unsustainable. There is therefore no basis upon which section 61 could apply.

The question posed

241. As the questions posed in these appeals have already been set out in the judgment of Rogers and Tang VPP, I do not propose to set them out a third time. But before turning to the questions themselves, I would preface my answers with some general remarks. The Board's unsustainable conclusion on the "no real money" issue was not a discrete issue. It inevitably coloured some of its findings, such as its key finding, as to sole or dominant purpose. Further, many of the questions were predicated on the sustainability or otherwise of the conclusion on the "no real money" issue. These matters coupled with the way in which the questions have been framed have made the task of answering them in any meaningful way difficult, and in some instances, the exercise becomes totally meaningless. For my part, I have also had difficulty in divining what the Board had in mind in some of the questions when it referred to "the other facts found by us".

242. Despite the subtext of the Board's decision which may be gleaned from its serious misgivings if not manifest scepticism concerning the need for pressing ahead with the September proposal when the original intention had been frustrated, its finding of a lack of commercial justification for interposing the 2 additional steps of the declaration of the dividend and HIT Investment on lending the same interest-free to Strategic and the inadequacies of the evidence adduced, the Board did not focus on important matters such as whether, given the extent of the internal funding required, the FRN issue could have been smaller, whether an interest-free loan could have been made to HITL instead of Strategic and so on. In this regard, I agree with what is said in paragraph 30 of the judgment of Rogers VP. The Board was simply too preoccupied with the 'no real money' issue. Quite apart from all this, there is the difficulty with the assessments on HITL being alternative assessments. The questions posed ignore this fact.

243. As the majority of this court do not consider further submissions necessary, I have endeavoured to answer the questions but there are some instances where, regrettably, I have not felt able to provide an answer.

244. Finally, I would add this. In the *Yau Wah Yau* case, I questioned whether the technicalities and the constraints of the case stated procedure still serve a useful purpose and are conducive to achieving a fair and just result. If anything, the present appeals forcefully bring that point home. In my view, the time is ripe for a review of that procedure and whether the ends of justice are best served by retaining it.

Case Stated of HIT Finance

Question (A) (1) Yes.

(2) No.

Question (B) (3) See paragraph 237.

(4) See paragraph 238-239.

Question (C) (5) No.

(6) No.

Question (D) (7) Not answered.

(8) Not answered.

Case Stated of HITL

Question (A) (1) Yes.

(2) No if it was predicated on there being "no real money".

(3) See paragraphs 238-239.

Question (B) (4) No.

(5) Yes.

Question (C) (6) Not answered.

(7) Not answered.

Hon Rogers VP:

245. There will therefore be an order *nisi* that the matter should be remitted to the Board with the questions that have been posed answered as per these judgments. There should be a further order *nisi* that the costs should be to the taxpayer in this court and before the Board of Review. There will be liberty to apply.

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

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