FACV No. 29 of 2005

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

FINAL APPEAL NO. 29 OF 2005 (CIVIL)
(ON APPEAL FROM CACV NO. 279 OF 2004)

BETWEEN

LAM SOON TRADEMARK LIMITED Appellant

and

COMMISSIONER OF INLAND REVENUE Respondent

Court: Chief Justice Li, Mr Justice Bokhary PJ, Mr Justice Chan PJ, Mr Justice Ribeiro PJ and Mr Justice Mortimer NPJ
Date of Hearing: 23 June 2006
Date of Judgment: 30 June 2006

J U D G M E N T

Chief Justice Li:

1. I agree with the judgment of Mr Justice Bokhary PJ.

Mr Justice Bokhary PJ:

Introduction

2. This is an appeal by a taxpayer, Lam Soon Trademark Ltd ("the Taxpayer"), against additional assessments to profits tax. Two questions on the operation of the Inland Revenue Ordinance, Cap. 112, arise. All my references to sections and subsections are to those of that Ordinance. The first question ("the preclusion question") is as follows. Is the making of an additional assessment under s.60 precluded by tax having originally been assessed on the basis of what sections 15 and 21A deem and such original assessment having become final and conclusive pursuant to s.70? "Yes" submits the Taxpayer while the Commissioner of Inland Revenue submits "No". The Board of Review, the High Court (Tang J, as he then was) and the Court of Appeal (Stock, Le Pichon and Yuen JJA) have all answered the preclusion question "No" in favour of the Commissioner.

3. As we shall see in detail when the circumstances of this case are examined, the original assessments were made on the basis of what sections 15 and 21A deemed, and became final and conclusive pursuant to s.70. So if we answer the preclusion question "Yes" in the Taxpayer's favour, its appeal would succeed on the basis that there was simply no power at all to make the additional assessments.

4. But if we answer the preclusion question "No" in the Commissioner's favour, then it would become necessary to consider the second question ("the voidness question") which is as follows. Is an additional assessment rendered void by an assessor's omission to deduct outgoings and expenses incurred in the production of chargeable profits? "Yes" submits the Taxpayer while the Commissioner submits "No". The voidness question arises under a fallback argument which the Taxpayer has erected upon the fact that the additional assessments had been made without deducting outgoings and expenses incurred in the production of its chargeable profits. This fallback argument runs thus. It is *ultra vires* (i.e. beyond the scope of his powers) for an assessor to make an additional assessment without deducting outgoings and expenses incurred in the production of chargeable profits. And any additional assessment made without such deduction is void. So the additional assessments in the present case, having been made without such deduction, are void.

5. Rejecting the Taxpayer's fallback argument, the Board of Review, the High Court and the Court of Appeal have all answered the voidness question "No" in the Commissioner's favour.

6. Shortly stated the circumstances of the case are as follows. The Taxpayer is a company incorporated in the Cook Islands. It is part of the Lam Soon group which includes a company listed on the Hong Kong Stock Exchange. Acquiring trademarks and earning royalties by licensing the use of its trademarks are and have at all material times been the Taxpayer's principal activities.

7. Section 14, which is the general charging provision for profits tax, provides as follows:

> "(1) Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate 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.
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> (2) In the case of –
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> (a) a corporation; and
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> (b) a corporation (' relevant corporation') to which a share of the assessable profits of a partnership is apportioned under section 22A and is charged in the partnership name under section 22,
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> profits tax shall be charged on the assessable profits of that corporation, or on that share of the assessable profits of that relevant corporation, as the case may be, at the rate specified in Schedule 8."

Original assessments made

8. Originally the assessor was of the view that the Taxpayer had not been carrying on business in Hong Kong. So he did not think that s.14 applied, and he turned to sections 15, 20B and 21A.

9. Section 15(1) provides that certain sums "shall be deemed to be receipts arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong". By virtue of paragraph (b) of this subsection, such sums include "sums, not otherwise chargeable to [profits tax], received by or accrued to a person for the use of or right to use in Hong Kong any … trademark". Sums thus deemed to be such receipts are among those described in s.20B(1) as the sums in respect of which a non-resident person is chargeable to tax. And s.20B(2) provides that "the non-resident person is chargeable to tax in respect of the sums described in subsection (1) in the name of any person in Hong Kong who paid or credited those sums to that or any other non-resident person". At the time material to the present case, s.21A read:

> "The assessable profits of a person arising in or derived from Hong Kong in respect of a sum deemed by section 15(1)(a) or (b) to be a receipt arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong shall, for the purposes of this Ordinance and notwithstanding any other provisions of this Part,

be taken to be 10 per cent of such sum."

10. In each of the four years of assessment concerned, namely 1990/91 – 1993/94, sums for the use in Hong Kong of its trademarks were credited to the Taxpayer by a different Hong Kong company in the Lam Soon group. For those years of assessment the Taxpayer was assessed under sections 15, 20B and 21A to profits tax in respect of those sums in the names of those four Hong Kong companies. Such tax totals $18,918,612.

11. Those were the original assessments. They were not objected to, and in due course they became final and conclusive pursuant to s.70 which reads:

> "Where no valid objection or appeal has been lodged within the time limited by this Part against an assessment as regards the amount of the assessable income or profits or net assessable value assessed thereby, or where an appeal against an assessment has been withdrawn under section 68(1A)(a) or dismissed under subsection (2B) of that section, or where the amount of the assessable income or profits or net assessable value has been agreed to under section 64(3), or where the amount of such assessable income or profits or net assessable value has been determined on objection or appeal, the assessment as made or agreed to or determined on objection or appeal, as the case may be, shall be final and conclusive for all purposes of this Ordinance as regards the amount of such assessable income or profits or net assessable value:
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> Provided that nothing in this Part shall prevent an assessor from making an assessment or additional assessment for any year of assessment which does not involve re-opening any matter which has been determined on objection or appeal for the year."

Additional assessments made

12. Later on the assessor formed the view that the Taxpayer had been carrying on business in Hong Kong after all. This meant, without recourse to any deeming provision, that the assessable profits on the Taxpayer' s royalties arose in or derived from Hong Kong and therefore attracted profits tax under s.14. In other words, it meant that the 10% limit set by s.21A did not apply. Accordingly, within the time limited for doing so, the assessor assessed additional amounts under s.60 for the years of assessment 1990/91 – 1993/94 in order to make up the shortfall involved. These additional assessments total $10,552,717.

13. Those are the additional assessments to which the Taxpayer objected. The Commissioner made a determination disagreeing with the objection. Whereupon the Taxpayer appealed to the Board of Review against the determination. It so appealed on a number of grounds, including grounds going to the points raised by the preclusion question and the voidness question.

The Board of Review rejected all the Taxpayer's grounds, dismissed its appeal and confirmed the additional assessments. From the Board of Review the Taxpayer appealed by way of case stated to the High Court. The case stated posed a number of questions including questions to the effect of the preclusion question and the voidness question. Having lost in the High Court on all questions, the Taxpayer went to the Court of Appeal. In that court the Taxpayer contended for an answer in the affirmative to the preclusion question and, as a fallback, for an answer in the affirmative to the voidness question. Having failed in those endeavours in the Court of Appeal, the Taxpayer now renews them before us.

Duty to assess

14. The assessor's duty to make assessments is laid down in s.59. This duty is to assess every person who is in the assessor's opinion chargeable with tax under the Inland Revenue Ordinance.

Power to make additional assessments

15. There is a power to make additional assessments. This power is provided for by s.60 which reads:

> "(1) Where it appears to an assessor that for any year of assessment any person chargeable with tax has not been assessed or has been assessed at less than the proper amount, the assessor may, within the year of assessment or within 6 years after the expiration thereof, assess such person at the amount or additional amount at which according to his judgment such person ought to have been assessed, and the provisions of this Ordinance as to notice of assessment, appeal and other proceedings shall apply to such assessment or additional assessment and to the tax charged thereunder:
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> Provided that –
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> (a) *(Repealed 2 of 1971 s. 39)*
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> (b) where the non-assessment or under-assessment of any person for any year of assessment is due to fraud or wilful evasion, such assessment or additional assessment may be made at any time within 10 years after the expiration of that year of assessment.
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> (2) Where it appears to an assessor that the whole or part of any tax repaid to a person (otherwise than in consequence of an assessment having been determined on objection or appeal) has been repaid by mistake, whether of fact or law, the assessor may, within the year of assessment to which the

repayment relates or within 6 years after the expiration thereof, assess such person in the amount of tax so repaid by mistake, and the provisions of this Ordinance as to notice of assessment, objection, appeal and other proceedings shall apply to such assessment and to the tax charged thereunder.

(3) No assessment shall be made under subsection (2) if the repayment was in fact made on the basis of, or in accordance with, the practice generally prevailing at the time when the repayment was made."

Answer to the preclusion question

16. The original assessments were made on the view that the Taxpayer had not been carrying on a trade, profession or business in Hong Kong. On that view, s.14 would not come into play but sections 15, 20B and 21A would do so in the manner described above. That would mean two things. On the one hand, it would mean that the Taxpayer was chargeable to profits tax in respect of sums received for the use in Hong Kong of its trademarks. But, on the other hand, it would also mean that such chargeability was limited to the extent that only 10% of each such sum was to be treated as assessable profits arising in or derived from Hong Kong.

17. Once it appeared to the assessor that the Taxpayer had been carrying on business in Hong Kong after all, it would automatically also appear to him that the original assessments should have been made under s.14 and therefore free from that 10% limit. Even so, the Taxpayer submits, it could not in law have appeared to the assessor that any of the original assessments had been at less than the proper amount. Why not? Because, the Taxpayer submits, no amount assessed on the basis of what sections 15 and 21A deemed can in law be seen as less than the proper amount — at least not after becoming final and conclusive under s.70.

18. I reject that submission for the following reasons. Statutory deeming is, as Lord Radcliffe explained in *St Aubyn v. Attorney General* [1952] AC 15 at p.53, resorted to for a variety of purposes. Even with that in mind, Viscount Simonds said in *Barclays Bank Ltd v. Inland Revenue Commissioners* [1961] AC 509 at p.523 that he nevertheless regarded the primary function of deeming as "to bring in something which would otherwise be excluded". That is what s.15 does. Section 15 does not exclude any person from chargeability with profits tax under s.14. And what s.15(1)(b) deems is that certain sums are receipts arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong. So where a person is chargeable with profits tax under s.14 there is simply no need for resort to s.15(1)(b) and therefore no room for it to apply. Invoking sections 15, 20B and 21A as was done in the present case would then be erroneous.

19. The Commissioner is right in his reliance on what we said in *Medical Council of Hong Kong v. Chow* (2000) 3 HKCFAR 144 at p.154B. There we spoke of the need to approach a statute as "a purposive unity". The Taxpayer's argument on the preclusion question

fails to do that, for it focuses on the operation of sections 15, 20B and 21A to the point of losing sight of s.60's proper role as preserved by the proviso to s.70.

20. Counsel for the Taxpayer cited what the Privy Council said in *Mangin v. IRC* [1971] AC 739 at p.746 E and *Lloyds Bank Export Finance Ltd v. CIR* [1991] 2 AC 427 at p.437 F. He did so for the proposition that the courts will, where the language of the statute so permits, avoid any literal interpretation that produces injustice, absurdity, anomaly or illogicality. Then he cited what Lord Nicholls of Birkenhead, giving the opinion of the House of Lords in *Barclays Finance Ltd v. Mawson* [2005] 1 AC 684, said at p.695 A-G. That was cited for the proposition that the interpretation of revenue statutes is now purposive, having been liberated from being blinkered. These propositions are plainly right. But I do not consider them of help to the Taxpayer, for I find nothing unjust, absurd, anomalous, illogical, blinkered or other than purposive in the interpretation contended for by the Commissioner.

21. Also cited by counsel for the Taxpayer were the decision of the House of Lords in *Bradbury v. English Sewing Cotton Co. Ltd* [1923] AC 744 and the decision of Privy Council in *Peterson v. CIR* [2005] STC 448. *Bradbury's* case concerns double taxation, which the present case does not; and *Peterson's* case concerns a general anti-avoidance provision, which the present case also does not. Neither of those two cases is of the assistance in deciding this one.

22. Section 60 comes into play where an error results in a person being assessed "at less than the proper amount". And an assessor will then have power under s.60, within the time limited by the section for doing so, to "assess such person at the additional amount at which according to his judgment such person ought to have been assessed". The proviso to s.70 leaves room for that course in circumstances like those of the present case. It does so by providing that the section shall not prevent an assessor from making an assessment or additional assessment for any year of assessment which does not involve re-opening any matter which has been determined on objection or appeal for the year. The additional assessments made in the present case do not involve re-opening any such matter.

23. For those reasons I answer the preclusion question "No" in favour of the Commissioner. In other words, I hold that the making of an additional assessment under s.60 is not precluded by tax having originally been assessed on the basis of what sections 15 and 21A deem and such original assessment having become final and conclusive pursuant to s.70.

Answer to the voidness question

24. The preclusion question having been answered in favour of the Commissioner, it becomes necessary to consider the voidness question raised by the Taxpayer's fallback argument. As I have already said, the assessor made the additional assessments without deducting outgoing and expenses incurred in the production of chargeable profits. And the Taxpayer's fallback argument, as I have already said, is that it is *ultra vires* (i.e. beyond the scope of his powers) for an

assessor to make an additional assessment without deducting outgoings and expenses incurred in the production of chargeable profits. And any additional assessment made without deducting such outgoings and expenses is void. So the additional assessments in the present case are void.

25. For its argument on voidness the Taxpayer points to s.16(1). This subsection provides that "[i]n ascertaining the profits in respect of which a person is chargeable to [profits tax] 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 [profits tax] for any period".

26. Is it for an assessor making an additional assessment to discover and deduct outgoings and expenses incurred in the production of a taxpayer's chargeable profits? Or is it for such taxpayer to put forward the outgoings and expenses that he says should be deducted and use them as a ground for objecting to — and, if that fails, appealing against — the additional assessment?

27. I say at once that I agree with Le Pichon JA that the decisions of the Privy Council in *Commissioner of Inland Revenue v. Mutual Investment Co. Ltd* [1967] AC 587 and *de Maroussem v. Commissioner of Income Tax* [2004] 1 WLR 2865 do not go to what has to be decided under the voidness question.

28. There is another matter which can also be dealt with quite shortly. It is the Taxpayer's attempt to derive support for its argument on voidness from what Lord Wilberforce said in *Vestey v. Inland Revenue Commissioners (Nos 1 and 2)* [1980] AC 1148 at pp 1171-1174, what Lord Millett NPJ said in *Collector of Stamp Revenue v. Arrowtown Assets Ltd* (2003) 6 HKCFAR 517 at p.554 F-G and what the High Court of Australia said in *Federal Commissioner of Taxation v. Peabody* (1994) 181 CLR 359 at p.382. Lying at the heart of what Lord Wilberforce said in *Vestey's* case is this sentence at p.1172D: "A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer and the amount of his liability is clearly defined". To similar effect Lord Millett NPJ stressed in the *Arrowtown* case at p.554 F-G that "the subject is to be taxed by the legislature and not by the courts". There is no inconsistency between any of that and the Commissioner's stance in the present case. Nor is there any inconsistency between such stance and what was said in *Peabody's* case at p.382 (concerning the exercise of a discretion to invoke a general anti-avoidance provision to cancel a tax benefit obtained under a tax scheme).

29. The decision of Mills-Owens J in *Mok Tsze Fung v. Commissioner of Inland Revenue* [1962] HKLR 258 was regarded by the courts below as relevant to the voidness question. But the circumstances of that case differ materially from those of this one, and I decide this case without reference to that one.

30. What outgoings and expenses were incurred in the production of a taxpayer's

chargeable profits are within his knowledge and are for him to put forward. The Commissioner can receive evidence, including evidence of such outgoings and expenses, when considering an objection. And the Board of Review can do the same when hearing an appeal. *Harley Development Inc v. CIR* [1996] 1 HKC 703, a decision of the Privy Council on appeal from Hong Kong, illustrates the width of the objection and appeals procedure under the Inland Revenue Ordinance. In that case the Taxpayer challenged the assessment as *ultra vires*. The Privy Council said (at p.708 F) that the objection and appeals procedure is perfectly competent to deal with that type of challenge.

31. For the foregoing reasons, I am of the view that an assessor's omission to deduct outgoings and expenses incurred in the production of a taxpayer's chargeable profits does not render an additional assessment void. It merely provides the taxpayer with a ground of objection or appeal. So I reject the Taxpayer's argument on voidness.

Conclusion

32. To recapitulate, I answer the preclusion question "No" in the Commissioner's favour, and hold as follows thereon. The making of an additional assessment under s.60 is not precluded by tax having originally been assessed on the basis of what sections 15 and 21A deem and such original assessment having become final and conclusive pursuant to s.70. As to the Taxpayer's fallback, I reject it. And I answer the voidness question "No" in the Commissioner's favour, and hold as follows thereon. An additional assessment is not rendered void by an assessor's omission to discover and deduct outgoings and expenses incurred in the production of a taxpayer's chargeable profits. It is for such taxpayer to put forward the outgoings and expenses that he says should be deducted, and use them as a ground of objection or appeal with a view to getting the additional assessment reduced through the deduction of such outgoings and expenses.

33. The parties accepted at the hearing that costs should follow the event. Having answered both the preclusion question and the voidness question in the Commissioner's favour, I would dismiss this appeal with costs so that the Commissioner, who was awarded costs below, will have his costs here and below.

Mr Justice Chan PJ:

34. I agree with the judgment of Mr Justice Bokhary PJ.

Mr Justice Ribeiro PJ:

35. I agree with the judgment of Mr Justice Bokhary PJ.

Mr Justice Mortimer NPJ:

36. I agree with the judgment of Mr Justice Bokhary PJ.

Chief Justice Li:

37. The Court unanimously dismisses the appeal with costs here and below.

(Andrew Li) Chief Justice	(Kemal Bokhary) Permanent Judge	(Patrick Chan) Permanent Judge

(R.A.V. Ribeiro) Permanent Judge	(Barry Mortimer) Non-Permanent Judge

Mr Barrie Barlow (instructed by Messrs Mallesons Stephen Jaques) for the appellant

Mr Ambrose Ho SC and Mr Eugene Fung (instructed by the Department of Justice) for the respondent