CACV 114/2009

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

CIVIL APPEAL NO. 114 OF 2009
(ON APPEAL FROM HCAL NO. 40 OF 2009)

Between

NAM TAI TRADING COMPANY LIMITED (formerly known as NAM TAI ELECTRONIC & ELECTRICAL PRODUCTS LIMITED) — Appellant

and

BOARD OF REVIEW (INLAND REVENUE ORDINANCE) — Respondent

Before: Hon Tang VP and Cheung JA in Court
Date of Hearing: 14 October 2009
Date of Judgment: 14 October 2009
Date of Reasons for Judgment: 28 October 2009

R E A S O N S F O R J U D G M E N T

Hon Tang VP:

1. The taxpayer was dissatisfied with the decision of the Board of Review given on 9 December 2008 and sought to appeal by way of a case stated pursuant to section 69 of the Inland Revenue Ordinance, Cap. 112.

2. The questions formulated by the taxpayer for the purpose are:

"(1) Whether, as a matter of law, and upon our holdings as to fact, it was open to us to dismiss the appeal and to confirm the relevant Determination of the Deputy Commissioner of Inland Revenue in respect of Additional Profits Tax Assessments for 1996/97 to 1998/99 and Profits Tax Assessment for 1999/2000.

(2) Whether as a matter of law:

(i) upon our holdings as to fact; alternatively

(ii) upon the evidence before us;

the only true and reasonable conclusion at which we could properly have, arrived, contrary to our Decision, was that:

(a) The management fees paid by the Taxpayer to its holding company Nam Tai Electronics, Inc. (NTEI) were outgoings and/or expenses incurred in the basis period for the respective years of assessment by the Taxpayer in the production of profits in respect of which the Taxpayer was chargeable to tax, and were expended for the purpose of producing profits, and were therefore allowable deductions under Sections 16 and 17 of the Inland Revenue Ordinance;

(b) The service agreements between the Taxpayer and NTEI and the payment of management fees by the Taxpayer to NTEI were transactions entered into by the Taxpayer in the production of profits in respect of which the Taxpayer was chargeable to tax, and were entered into for the purpose of producing profits, and were not transactions entered into for the sole or dominant purpose of enabling the Taxpayer to obtain tax benefits within the meaning of Section 61A of the Ordinance;

(c) The legal and professional fees totalling $4,429,290 paid to NTEI and Nam Tai Electronic (Shenzhen) Co Ltd. by the Taxpayer were

outgoings and/or expenses incurred in the basis period for the respective years of assessment by the Taxpayer in the production of profits in respect of which the Taxpayer was chargeable to tax, and were expended for the purpose of producing profits, and were therefore allowable deductions under Sections 16 and 17 of the Inland Revenue Ordinance;

(d) The payment of the aforesaid legal and professional fees to NTEI and NTSZ were transactions entered into by the Taxpayer in the production of profits in respect of which the Taxpayer was chargeable to tax, and were expended for the purpose of producing profits, and were not transactions entered into or carried out for the sole or dominant purpose of enabling the Taxpayer to obtain tax benefits within the meaning of Section 61A of the Ordinance;

(e) The legal and professional fees totalling $4,624,023 charged in the accounts of the Taxpayer for the year of assessment 1999/2000 were outgoings and/or expenses incurred in the basis period for the relevant year of assessment by the Taxpayer in the production of profits in respect of which the Taxpayer was chargeable to tax, and were expended for the purpose of producing profits, and were therefore allowable deductions under Sections 16 and 17 of the Inland Revenue Ordinance;

(f) The management fees receivable from Zastron Plastic and Metal Products (Shenzhen) Ltd. written off in the year of assessment 1998/99 were bad and/or doubtful debts becoming bad in the basis period for the relevant year of assessment and/or were outgoings and/or expenses incurred in the said basis period by the Taxpayer in the production of profits in respect of which the Taxpayer was chargeable to tax, so incurred for the purpose of producing profits, and were therefore allowable deductions under Sections 16 and 17 of the Ordinance.

(3) Whether as a matter of law:

(i) upon our holdings as to fact; alternatively

(ii) upon the evidence before us;

the only true and reasonable conclusion contradicted our respective holdings that:

(a) The management fees as well as the other deductible fees were simply designed in a way to cover the Taxpayer's overhead;

(b) The operations in Hong Kong were merely to receive customers (as opposed to deriving profits from the intra-group pricing policy and/or trading in electronic products);

(c) There was no way in which it was necessary for the Taxpayer to incur such management fees for the purpose of its trading business;

(d) The management fees in question could never have been regarded as expenses incurred in the production of the Taxpayer's profits;

(e) The entering into the Service Agreements and the purported payment of management fees to NTEI are transactions entered into for the sole or dominant purpose of enabling the Taxpayer to obtain a tax benefit;

(f) The Determination of the Deputy Commissioner of Inland Revenue in respect of Additional Profits Tax Assessments for 1996/97 to 1998/99 and Profits Tax Assessment for 1999/2000 appealed against was correct.

(4) Whether we were correct in law to direct ourselves that the authority of *Usher's Wiltshire Brewery Ltd. v Bruce* ((1915) AC 433) is a case very limited to its own specific facts.

(5) Whether we were wrong in law in failing to direct ourselves sufficiently or at all that:

(i) In order to be deductible, it is not required that the expenditure in question was necessary, nor that it was of direct and immediate benefit to the trade; a voluntary payment, made on grounds of commercial expediency in order indirectly to facilitate the carrying on of business can suffice.

(ii) To ascertain whether the payment was made for the purposes of a taxpayer's trade it is necessary to discover his object in making the payment; save in obvious cases which speak for themselves, this

involves an inquiry into the taxpayer's subjective intentions at the time of the payment.

(iii) Where a payment is made because, without it, the taxpayer would have no business from which to make any profits, that is a deductible expense; it is not relevant to consider whether the decision to make the payment was a wise one, or whether it ultimately led to profits.

(iv) Tax is avoided and a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction; the taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had."

3. By letter dated 16 January 2009, the clerk to the Board of Review wrote to Messrs Wilkinson & Grist ("W&G") the taxpayer' s solicitors saying that the Board was:

> "… of the view that the questions are unparticularised and they do not identify questions of law that at this stage we are prepared to state. Dealing with each of the respective numbered paragraphs of the letter:-
>
> 1. This is a very broad compound question, as presently drafted, and does not disclose a specific question of law.
>
> 2. This paragraph, in essence, is a summary of the Taxpayer's case and does not attempt to state or particularise a question of law.
>
> 3. This paragraph as drafted is unparticularised and indeed does not attempt to put forward a coherent question or questions for us to state. It is basically an attempt to restate some of the submissions advanced by the Taxpayer.
>
> 4. This does not amount to a question.
>
> 5. This question is difficult to make any sense of and, further, is insufficiently particularized by reference to the findings made by us."

4. By letter dated 3 March 2009, W&G asked whether the Board would be agreeable to formulating its own question or questions of law upon which to state the case. If so, the taxpayer while reserving their rights would be prepared to accept the case containing a question or question so formulated subject to their seeking an order from the court of instance under section 69(4) of the

ordinance. Also they wanted the Board to confirm explicitly their refusal to state a case because the taxpayer might wish to apply for an order of mandamus.

5. By letter dated 6 March 2009, the Board responded:

> "Before we take the matter further, we would suggest that Messrs Wilkinson & Grist liaise with the Department of Justice and seek their views as to whether or not any of the questions set out in Messrs Wilkinson & Grist's letter of the 8th January 2009 are capable of identifying questions of law.
>
> Following such liaison, it may be the case that the parties themselves can jointly formulate questions, to their mutual satisfaction, that in turn can then be put to us for our further review and consideration.
>
> We would suggest that the parties revert back to the Board within three weeks from the date of this letter."

6. W&G then sought the view of the Department of Justice. Their response dated 19 March 2009 stated:

> "The Board should decline a request to state a case if no proper question of law can be identified by the applicant: *Aust-Key Co Ltd v CIR* [2001] 2 HKLRD 275, at 283B.
>
> A proper question of law is one which:
>
> (1) is a question of law;
>
> (2) relates to the decision sought to be appealed against;
>
> (3) is arguable; and
>
> (4) would not be an abuse of process of such a question to be submitted to CFI for determination.
>
> D26/05 (2005/06) 20 IRBRD 174, §3.
>
> To determine whether a question is a question of law, it is the substance rather than the form of the question which matters. In *CIR v Inland Revenue Board of Review* [1989] 2 HKLR 40, at 54 A-B, Hon. Barnett J. observed thus:

> ' The Board can, and should, decline to state a case where the only question raised is, in substance, a question of fact and not a question of law.'

We do not consider any of the questions proposed by you in the said letter are proper questions of law or are capable of identifying proper questions of law.

Quite apart from what is stated by the Clerk to the Board of Review in his letter dated 16 January 2009, which we fully support, we consider that Questions 1 to 5 are not proper questions of law for the following reasons.

Questions 1 and 3(f). The questions are no more than a general challenge to the Board's conclusion which confirmed the determination of the Deputy Commissioner of Inland Revenue and thus dismissed the appeal. They do not indicate in any way how or why the Board might be said to be wrong as a matter of law. As Hon. Barnett J. observed in *CIR v Inland Revenue Board of Review* [1989] 2 HKLR 40, at 50F-G,

> ' ... I am not prepared to accept that an applicant for a case stated may rely on a question of law which is imprecise or ambiguous and which gives the Board no clear idea of what material must be marshalled in their case.'

Questions 2 (a)-(f). The questions, in substance, are questions of fact in disguise. Further the applicant has failed even to identify which of the Board's finding of primary fact or inference from primary fact it seeks to challenge or the basis of the challenge: *CIR v Inland Revenue Board of Review* [1989] 2 HKLR 40, at 58A. The questions are improper as they give the Board no clear idea of what material is to be marshalled in support of the applicant's case.

Questions 3 (a)-(e). The questions, in substance, are questions of fact in disguise. Further the applicant has failed to distinguish which of the holdings set out in the questions are challenged as findings of primary fact and which holdings are challenged as inferences from primary facts: *CIR v Inland Revenue Board of Review* [1989] 2 HKLR 40, at 58A. The questions are improper as they give the Board no clear idea of what material is to be marshalled in support of the applicant's case.

Question 4. This question is improper since it is most imprecise and ambiguous and identifies no specific question of law. Further, as a matter of law, it is plainly correct for the Board to treat every authority as being decided on its own facts and that the task of the Board is ' to look at the facts that are before us' [paragraph 59 of the Board's Decision].

Question 5 (i)-(iv). The questions are improper since the applicant has failed to identify which findings made by the Board or which parts of the Decision of the Board it seeks to challenge and how any of the questions raised relate to those findings or parts of the Decision."

7. Then by letter dated 30 March 2009, W&G asked the Board:

"… to confirm whether or not it is willing to state any of the questions set out in (their) letter of 8th January, 2009, or any question or questions of its own formulation, for the opinion of the Court of First Instance".

8. However, without waiting for an answer, on 15 April 2009, the taxpayer gave notice of application for leave to apply for judicial review. In the Form 86, the decision of the Board in respect of which leave was sought was stated to be their decision of 16 January 2009, which was described as a de facto decision under "Relief Sought".

9. Leave was refused by A Cheung J on 23 April 2009 with the following observations:

"Observations for the applicant:

1. No oral hearing has been requested and the Court does not require any.

2. The Court agrees with the views expressed in the Department of Justice's letter dated 19 March 2009.

3. Questions (5)(i)-(iii) may, if properly refined by reference to the relevant findings or parts of the Decision of the Board, potentially become proper questions of law to be stated by the Board. Question 5(iv), as it is presently framed, is simply incomprehensible.

4. As it is, no arguable case for leave has been made out.

5. The applicant should seriously review and revise its questions for the Board's reconsideration and hopefully some meaningful and proper questions may then be stated by the Board for the purposes of the applicant' s intended appeal - in which event, any further dispute regarding the framing of questions can be dealt with by the Court of First Instance pursuant to s 69(4) of Cap 112.

6. Resort to judicial review in the present type of situation is quit unnecessary and ' satellite [JR] litigation' is strongly discouraged.

> 7. The above observation does not apply to any genuine challenge to the constitutionality of the case stated procedure in s 69. See judgment of this Court in HCAL 40/2008, 20 April 2009."

10. It is clear that the application for leave to apply for judicial review was premature. There was no decision which could have been challenged by way of judicial review.

11. At the hearing before us, Sir John produced a copy of a decision of the Board of Review dated 22 April 2009 where they stated that:

> "… questions 1 to 5 are not proper questions of law. The questions that were put forward are unparticularized and do not clearly identify other questions of law that enable us to state a case and we decline to do so."

This decision though made on 22 April 2009 was not received by the taxpayer until 23 April 2009, the same day its application for leave was refused by A Cheung J. The fact that the Board has subsequently come to the decision which they did would not alter the fact that the taxpayer's application to challenge the decision of 15 January 2009 was not supportable.

12. Sir John, appearing with Mr John J E Swaine, mentioned the possibility of an amendment but none had been formulated nor leave formally sought. In any event, even if there had been a formal application for leave to amend, I would not have been disposed to accede to it, even assuming that an amendment to challenge a decision which had not been made at the time when the application for leave was made could properly be permitted.

13. Sir John accepted that an applicant for a case stated has to identify a question of law which it was proper for the court to consider. Mr John J E Swaine spoke of experience in cases where more than one hearing before the Board of Review was necessary in order to have the question properly formulated.

14. It is important not to permit any inroad into the useful practice where the formulation of the questions as well as the case stated itself is the result of genuine and cooperative effort on the part of all the parties involved. See the comments of Sir Alan Huggins, VP in *Chinachem Investment Co. Ltd. v Commissioner of Inland Revenue* (Civil Appeal 1986, No. 116) cited in *CIR v Inland Revenue Board of Review and Anor* [1989] 2 HKLR 40, at page 48. Here it is obvious that the taxpayer had not exhausted the process. The court should be slowed to countenance such conduct. I respectfully agree with paras. 5 and 6 of A Cheung J's observations.

15. Since I would have dismissed the appeal for the above reasons alone it is unnecessary for me to consider the questions drafted on behalf of the taxpayer. Moreover, I agree with the other observations of A Cheung J. However, in deference to the submissions of Sir John, I will comment briefly on the first question.

16. The decision of the Board ran to 58 pages. The issues before them turned on whether the various management fees and other deductions claimed on behalf of the taxpayer were allowable pursuant to section 16(1) and section 17(1)(b) of the Ordinance. They decided they were not incurred or expended in or for the production of the relevant profits. They went on to find that the transactions in questions were carried on for the sole or dominant purpose of enabling the taxpayer to obtain the tax benefit as provided for under section 61 of the IRO.

17. Mr John J E Swaine submitted that the first question raised a question of law. He cited in supported case D65/88(A), a decision of the Board of Review chaired by Henry Litton QC (as he then was) in 1989 given after a hearing before the Board regarding the formulation of questions for a case stated. There, the Commissioner applied for a case stated and suggested 10 questions to be answered by the court. Following correspondence the 10 questions were amended in various ways. The matter then came before the Board on the argument by the taxpayer that the so-called questions of law were in reality an attempt by the Commissioner to have the appeal reheard on its evidence. The Board of Review ruled that it was an attempt by the Commissioner to have the case reheard on its evidence and that there was no question of law to be stated. The Board then refused to state the case. In the cause of the submission, however, the Board suggested stating a case in the form set out in *Milnes v Beam* [1975] 50 TC 675 to this effect:

> "The question of law for the opinion of High Court is whether, on the facts found, our decision was correct."

But the matter was not pursued because:

> "… Counsel for the Commissioner would not accept our suggested formulation of the question, and insisted that such a formulation would not enable him to argue the real points of his case. We should add in parenthesis that Counsel for company also submitted that, in view of the terms of letter dated 18 February 1989, the suggested formulation is not open to us. With such an unanimous view expressed, we did not pursue the matter further." at para. 32.

18. I accept that the question as formulated by Mr Litton QC raises a question of law and, depending on the circumstances, it may be a proper question. Here, however, the Board has found as a matter of fact that the expenses and deductions were not incurred or expended in or for the purpose of the making of profits. It is difficult to understand how the first question could be a proper question in the context of this case. On those findings of fact, the application has no reasonable prospect of success. That being the case, I believe the Board was entitled to ask the taxpayer to reformulate the question.

19. Sir John referred us to *Po Fun Chan v Winnie Cheung* [2007] 10 HKCFAR 676 for the proposition that sometimes the true and only reasonable conclusion contradicts the

determination appealed against, and, if so, the appellant court would assume that the determination resulted from an error of law. He also submitted that Question (1) does not involve visiting the evidence before the Board (as opposed to the facts as found by the Board). But it is not apparent from Question (1) that any facts would be challenged.

20. For the above reasons, I dismissed the appeal with costs.

Hon Cheung JA:

21. I agree.

(Robert Tang)
Vice-President

(Peter Cheung)
Justice of Appeal

Sir John Swaine, SC and Mr John J E Swaine, instructed by Messrs Wilkinson & Grist, for the Appellant/Taxpayer

Mr Paul H M Leung, instructed by the Department of Justice, for the Commissioner