FACV No. 29 of 2008

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

FINAL APPEAL NO. 29 OF 2008 (CIVIL)
(ON APPEAL FROM CACV NO. 22 OF 2008)

Between:

NGAI LIK ELECTRONICS COMPANY LIMITED Appellant

and

THE COMMISSIONER OF INLAND REVENUE Respondent

Court: Chief Justice Li, Mr Justice Bokhary PJ, Mr Justice Chan PJ, Mr Justice Ribeiro PJ and Sir Anthony Mason NPJ
Date of Hearing: 8 July 2009
Date of Judgment: 24 July 2009

J U D G M E N T

Chief Justice Li:

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

Mr Justice Bokhary PJ:

2. I agree with the judgment of Mr Justice Ribeiro PJ.

Mr Justice Chan PJ:

3. I agree with the judgment of Mr Justice Ribeiro PJ.

Mr Justice Ribeiro PJ:

4. This appeal concerns the operation of the anti-avoidance provisions of section 61A of the Inland Revenue Ordinance[1] ("the Ordinance"). The Commissioner[2] contends that the appellant, Ngai Lik Electronics Co Ltd ("the taxpayer"[3]), engaged in a transaction caught by the section so as to justify additional assessments raised on the taxpayer in respect of five years of assessment from 1991/92 to 1995/96. The taxpayer's appeal against such assessments to the Board of Review ("the Board") was dismissed[4] and the Board was required to state a case on a question of law for the opinion of the Court of First Instance in the following terms:

> "Whether, on the facts found by the Board, the Board erred in law in concluding that the Taxpayer and the other participants in the Scheme[5] entered into or carried out the Scheme for the dominant purpose of enabling the Taxpayer to obtain a tax benefit?"

5. The question so stated is narrowly expressed. However, as Le Pichon JA noted,[6] it has been treated as raising broader issues in the courts below. The Court has heard argument on, and I will deal with, such broader issues, including the question whether the relevant transaction conferred a tax benefit on the taxpayer within the meaning of section 61A and whether the additional assessments were validly made.

6. The taxpayer's appeal by way of case stated was dismissed by Reyes J,[7] as was its further appeal to the Court of Appeal.[8] The matter comes before this Court by leave of the Court of Appeal under section 22(1)(a) of the Court's statute.

A. The taxpayer's business

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1 Cap 112.

2 A term I use to include the Assistant Commissioner who is mentioned in section 61A.

3 For consistency, the appellant is referred to throughout as "the taxpayer" even when it is referred to by other abbreviations such as "NLE" as in the Board's decision.

4 BR/96/00, 22 February 2007; (2007-2008) 22 IRBRD Case No D83/06.

5 Identified in §163 of the Decision.

6 Court of Appeal §20.

7 HCIA 5/2007 (11 December 2007).

8 Le Pichon JA, Stone and Chu JJ, CACV 22/2008 (15 October 2008).

A.1 The taxpayer's business before the re-organisation

7. The taxpayer was incorporated in Hong Kong on 10 April 1981, its directors being Mr Lam Man-chan ("Mr Lam"), his wife Madam Ting Lai-ling ("Madam Ting") and Mr Lam Chun-lai. The taxpayer's business at that stage involved the design, manufacture and trading of electronic audio products.

8. In 1987, production was moved to factories in Shenzhen and Dongguan on the mainland. The taxpayer continued to carry on its business in Hong Kong, entering into contracts with customers for the manufacture and sale of audio products produced under the customers' own labels. It fulfilled those contracts by sub-contracting production on the mainland to Din Wai Company and Shing Wai Company which were the trading styles or sole proprietorships of Madam Ting and Mr Lam respectively. Din Wai Company and Shing Wai Company in turn sub-contracted the work to mainland parties who supplied the labour force and, in some cases, the factory premises. The sole proprietorships provided the production equipment, managed the workers and paid processing fees to the local enterprises. The finished goods were delivered or shipped by the taxpayer to its customers.

9. The taxpayer's financial statements for 1988/89, 1989/90 and 1990/91 showed the following:

Table 1: Taxpayer's financial statements for 1988/89 to 1990/91

	1988/89	1989/90	1990/91
Raw materials opening stock	8,429,006.89	12,330,268	14,676,441
Purchases during the year	218,163,859.18	231,748,098	310,640,311
Raw materials closing stock	12,330,268.55	14,676,441	30,531,391
Direct labour	1,721,313.30	1,117,609	952,789
Subcontracting charges			39,158,146
Opening (stock of) work-in-progress	3,052,195.17	3,053,716	8,218,068
Closing (stock of) work-in-progress	3,053,716.16	8,218,068	346,354
Cost of production/goods manufactured	215,946,600.36	227,064,004	346,970,109

10. For the years 1988/89 and 1989/90, the taxpayer offered up the whole of its profits for taxation. Then in 1990/91, when Messrs Ernst & Young ("E&Y") became its auditors, it claimed that a proportion of its profits derived from the manufacturing process and were therefore sourced offshore and not subject to Hong Kong tax. It quantified those profits as $4,337,126, which was a figure representing 1.25% of the cost of production [$346,970,109 x 1.25% = $4,337,126]. It offered up for taxation the balance of its profits for that year, described as "trading profit" in the amount of $4,226,075 (to be distinguished from the "offshore factory profit" just mentioned). That claim was accepted by the Revenue.

A.2 Advice from E&Y

11. Certain documents prepared by E&Y containing tax planning advice were placed before the Board. The advice revolved around putting in place arrangements "which would enhance the [taxpayer's] claim to have part of its profits treated as exempt from Hong Kong tax" and involved suggested schemes whereby profits would accrue to separate legal entities, one undertaking only Hong Kong activities and the others, offshore companies, undertaking only non-Hong Kong activities, so that the profits of the latter would not be assessable. Master supply and service agreements were also suggested to govern the supply of goods and the provision of services among the entities involved. It was also envisaged that the group would seek a public listing.

A.3 The re-organisation

12. On 19 March 1991, Shing Wai Co Ltd ("SW(HK)") was incorporated in Hong Kong and on 1 April 1991, pursuant to an oral agreement between that company and Mr Lam, SW(HK) acquired the assets and liabilities of Shing Wai Company which then ceased business. The Board found that SW(HK) carried on business outside Hong Kong in 1991/92 and 1992/93 before its business was taken over, as noted below.

13. On 2 August 1991, Din Wai Electronics Limited ("DWE") was incorporated in the BVI and, pursuant to an oral agreement made between that company and Madam Ting on 1 September 1991, DWE acquired the assets and assumed the liabilities of Din Wai Company which then ceased operations.

14. Ngai Wai Plastic Manufacturing Limited ("NWP") and Shing Wai Limited ("SWL") were incorporated as BVI companies on 12 August 1991 and 12 March 1992 respectively.

15. On 29 June 1992, Ngai Lik Industrial Holdings Limited ("NLH") was formed in Bermuda and became, in August 1992, the holding company of the taxpayer, SW(HK), DWE, NWP and SWL. The latter three companies will together be referred to as "the three BVI companies" and all six of the aforesaid companies will together be called "the Group". The directors of the three BVI companies were themselves BVI companies.

16. On 25 September 1992, NLH was listed on the Hong Kong Stock Exchange with Mr Lam as its chairman and the largest beneficial shareholder.

17. Meanwhile, on 1 June 1992 DWE entered into three master agreements:

(a) DWE agreed to supply and the taxpayer to purchase the audio products specified on the terms that the taxpayer would have the right to refuse to take delivery if the landed cost of DWE's products should exceed by more than

10% the cost of goods from the cheapest alternative supplier, such agreement deemed effective from 1 April 1992.

(b) SWL agreed to supply and DWE to purchase electric wires and other specified components on the same terms as those just mentioned.

(c) DWE entered into an agreement with NWP to purchase plastic assembly and other specified components manufactured by NWP on the same terms.

18. On the same date, 1 June 1992, the taxpayer entered into three "representative and services agreements":

(a) It agreed to act as SWL's agent to source raw materials from Hong Kong suppliers; to act as authorised signatory on its bank accounts; to invoice purchasers; to receive and give good receipts and discharges for all amounts paid; and to conduct correspondence on the shipment of products. SWL agreed to reimburse the taxpayer for disbursements made on its behalf and to pay it a remuneration of 5% of the expenses incurred.

(b) Two other agreements on essentially the same terms were entered into with NWP and DWE.

19. As from 1 April 1993, SWL took over the assets and liabilities of SW(HK).

A.4 The taxpayer's business after the re-organisation

20. The taxpayer, carrying on business in Hong Kong, continued to deal with external customers. More than 250 customers were involved and its staff solicited new customers. Orders were placed by customers with the taxpayer for production and delivery of electronic audio equipment under the customers' own labels. When an order was received, the taxpayer placed production orders with DWE which had design and manufacturing facilities on the mainland, employing some 50 staff in the design department and a workforce of 1,400 to 1,600 workers. Some 60% to 70% of the components required by DWE were obtained from SWL and NWP who manufactured such components in mainland factories. The rest were acquired from third parties.

21. The taxpayer undertook the sourcing of raw materials required by SWL and NWP from Hong Kong and other suppliers and acted as agent for the three BVI companies. After taking delivery of components manufactured by SWL, NWP and other suppliers, DWE would produce the finished product pursuant to processing agreements it had with mainland enterprises.

22. Over 96% of SWL's and NWP's production was sold to DWE which, after producing the finished goods, sold the whole of its production to the taxpayer, making delivery to Hong Kong by lorry. The taxpayer then delivered the goods to its customers.

A.5 The re-casting of the taxpayer's financial statements

23. As from 1991/92, the taxpayer's financial statements described the Group's principal activity as "trading of consumer audio products, telephone sets and car stereo systems". In previous years, it had been described as "the manufacture and trading of audio equipments and products". For the years 1991/92 to 1995/96, the taxpayer's income and profits were shown in its financial statements to be as follows:

Table 2: Taxpayer's income and profits for 1991/92 to 1995/96

	1991/92	**1992/93**	**1993/94**	**1994/95**	**1995/96**
	$	$	$	$	$
Sales	454,572,331	611,078,765	799,962,870	875,554,172	1,089,334,354
Cost of sales	427,575,598	564,593,980	750,232,308	824,109,986	1,035,130,907
Gross profit	26,996,733	46,484,785	49,730,562	51,444,186	54,203,447
Other income	908,441	5,081,117	2,180,275	2,591,146	3,024,479
	27,905,174	51,565,902	51,910,837	54,035,332	57,227,926
Less:					
Selling and administrative expenses	16,839,365	36,264,473	41,981,635	47,535,179	48,565,446
Financial expenses	3,986,252	5,007,669	2,344,489	5,122,090	4,681,902
Operating profits	7,079,557	10,293,760	7,584,713	1,378,063	3,980,578

24. Included in the Cost of Sales were the following payments to Group companies:

Table 3: Cost of sales attributable to payments to Group companies

	1991/92	**1992/93**	**1993/94**	**1994/95**	**1995/96**
	$	$	$	$	$
Din Wai Company	13,504,855	NA	NA	NA	NA
SW(HK)	39,690,947	NIL	NIL	NIL	NIL
DWE	26,937,917	550,767,076	739,362,537	817,090,000	1,029,420,964
NWP	1,818,978	NIL	NIL	NIL	NIL
	81,952,697	550,767,076	739,362,537	817,090,000	1,029,420,964

25. The management fee income was shown in the taxpayer's accounts as follows:

Table 4: Management fees received by taxpayer

	1991/92	**1992/93**	**1993/94**	**1994/95**	**1995/96**
	$	$	$	$	$
Received from:					
DWE	-	1,450,000	-	-	-
SW(HK)	-	350,000	-	-	-
NWP	-	200,000	-	-	-
Group Companies	-	-	-	18,000	50,000
Total	NIL	2,000,000	NIL	18,000	50,000

A.6 Sales by DWE to the taxpayer

26. Although the master agreement between the taxpayer and DWE provided for sales to the taxpayer at prices which the taxpayer was bound to accept provided the landed cost of the goods did not exceed by more than 10% the cost of purchasing from the cheapest alternative supplier, the Board found that this was not how sales by DWE to the taxpayer were actually carried out in practice. The two parties merely recorded the quantities of the goods ordered and delivered and the price was only subsequently decided upon by the taxpayer's accounts department on an annual basis.

27. The Board found that the "practical or commercial end result" was that:

> "(a) the mode of operation of the Group had not changed;
>
> (b) while the taxpayer's turnover represented the Group's turnover, the taxpayer's profits dropped and its contribution to the profits of the Group dropped from 31.19% in 1991/92 to 7.19% in 1995/96;
>
> (c) The taxpayer's drop in profitability was offset by the profitability of the three BVI companies and SW(HK) which operated offshore."

A.7 Sales by NWP and SWL to DWE

28. The Board also focussed on the dealings between DWE and the two BVI companies which supplied it with components. NWP and SWL were contractually permitted to charge DWE up to 10% more than the cheapest alternative supplier for components, but this was again ignored in practice. From 1993/94 onwards, DWE received annual discounts over and above what were described as normal sales discounts. These were shown in the three BVI companies' financial statements as follows:

Table 5: Annual discounts given to DWE

By	Period	Sales discount $	Additional discount $
NWP	12-8-1991 – 31-3-1992	-	-
	1-4-1992 – 31-3-1993	759,312.54	-
	1-4-1993 – 31-3-1994	1,816,574.16	-
	1-4-1994 – 31-3-1995	1,013,715.89	16,762,000.00
	1-4-1995 – 31-3-1996	(no information)	14,400,000.00
SWL	12-3-1992 – 31-3-1993	-	-
	1-4-1993 – 31-3-1994	4,786,975.95	6,000,000.00
	1-4-1994 – 31-3-1995	5,029,065.43	25,130,000.00
	1-4-1995 – 31-3-1996	(no information)	21,600,000.00

B. The Assessments and Determination

29. The taxpayer filed returns for the years 1991/92 to 1995/96 and offered up for assessment all the profits shown in the financial statements mentioned above. On various dates, the assessor raised the following assessments without objection by the taxpayer :

Table 6: Original assessments

Year of assessment	Assessable profits $
1991/92	2,215,495
1992/93	8,732,329
1993/94	4,268,207
1994/95	4,547,092
1995/96	5,697,538

30. However, on 13 August 1997, the Commissioner took the view that the "arrangement involving [SW(HK) (replaced by SWL from 1993/94 onwards), DWE and NWP] and the inter-company pricing operation" were "schemes entered into for the sole or dominant purpose of obtaining tax benefit" and raised additional assessments on the taxpayer pursuant to section 61A. This was done by treating the whole of the profits shown in the accounts of SW(HK) (and as from 1993/94 SWL), NWP and DWE as the taxpayer' s assessable profits.

Table 7: Commissioner' s additional assessments dated 13.8.97

	1991/92 $	1992/93 $	1993/94 $	1994/95 $	1995/96 $
Profits shown in the accounts of:					
SW(HK)	7,554,699	8,150,770	-	-	-

DWE	8,751,436	31,866,456	1,532,375	3,089,305	4,789,915
SWL	-	-	43,732,248	19,881,773	29,701,806
NWP	194,584	13,200,886	11,651,497	5,199,601	19,961,649
Additional assessable profits	16,500,719	53,218,112	56,916,120	28,170,679	54,453,370
Tax payable thereon	2,722,619	9,313,170	9,960,321	4,648,162	8,984,806

31. Objections were lodged by E&Y on the taxpayer's behalf, contending that section 61A had no application and that even if it did apply, the offshore manufacturing profits were not taxable. In response, the assessor "conceded to exclude 50% of the profits as amounts derived outside Hong Kong" and revised the additional assessments so as to reduce the assessable profits by 50%.

Table 8: The revised additional assessments

	1991/92	**1992/93**	**1993/94**	**1994/95**	**1995/96**
	$	$	$	$	$
Profits assessed	16,500,719	53,218,112	56,916,120	28,170,679	54,453,370
Less: Amount conceded as non-taxable	8,250,360	26,609,056	28,458,060	14,085,340	27,226,685
Revised additional assessable profits	8,250,359	26,609,056	28,458,060	14,085,339	27,226,685
Tax payable thereon	1,361,309	4,656,585	4,980,160	2,324,081	4,492,403

32. By Determinations dated 26 June 2000, the Commissioner confirmed the additional assessments as revised, stating:

> "I consider that 50% of the profits of [SW(HK)] and the [three BVI] Companies is not an unreasonable estimate of the excessive costs and expenses that were not incurred in the production of [the taxpayer's] chargeable profits in the circumstances."

C. Section 61A

33. Section 61A materially provides as follows:

> (1) This section shall apply where any transaction has been entered into or effected after [the commencement date] ... 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" means the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof;

> "transaction" includes a transaction, operation or scheme whether or not such transaction, operation or scheme is enforceable, or intended to be enforceable, by legal proceedings.

34. Three intersecting conditions must be satisfied before the Commissioner can exercise her power to raise an assessment under section 61A(2). They are that:

(a) a transaction (broadly defined to include an operation or scheme) has been entered into;

(b) such transaction has, or would have had but for this section, the effect of conferring a tax benefit on the relevant person (that is, on the taxpayer against whom the section has been invoked); and

(c) viewing the transaction through the prism of the seven matters enumerated in section 61A(1)(a) to (g), it would objectively be concluded that it was entered into or carried out for the sole or dominant purpose of enabling the taxpayer to obtain a tax benefit.

35. If section 61A is to be applied, it is essential to identify with some precision what the tax benefit allegedly conferred (or which would, but for the section be conferred) on the taxpayer consists of. Only then can one confidently identify the transaction, if any, which has the effect of conferring that tax benefit on him. And only then is one able to examine that transaction in the light of the seven specified matters to determine whether its sole or dominant purpose is to enable the taxpayer to obtain a tax benefit.

36. It will be necessary later to consider the meaning of "tax benefit" as defined in section 61A(3). However, for present purposes, the point to be emphasised is that the three interlocking conditions – transaction, tax benefit and dominant purpose – must be properly aligned and approached with the necessary degree of precision if the application of section 61A is not to miscarry.

37. Moreover, as discussed more fully later, where an assessment is raised under section 61A, it must be justifiable as a reasonable and proper exercise of the power.

38. Mr Barrie Barlow SC, appearing for the taxpayer, seeks to argue that properly understood, section 61A has no application to a case like the present because there is no "tax benefit" within the meaning of the section. He contends furthermore that even if the section is engaged, the Commissioner has misapplied its provisions and in particular, that her additional assessments cannot be supported. Mr Ambrose Ho SC, appearing with Ms Joyce Leung for the

Revenue, seeks to uphold those additional assessments and the decisions of the Board and the courts below.

D. The application of section 61A in the Board and in the courts below

D.1 The Board' s application of section 61A

D.1a The Board' s formulation of the Scheme

39. The Board accepted[9] the Commissioner' s formulation of the relevant transaction (which is referred to as "the Scheme") as consisting of :

> "the Scheme as a whole with its component parts collectively, which consisted of undertaking and implementation of all the steps and matters set out below:-
>
> (1) The acquiring of the three BVI companies in around August 1991 to March 1992;
>
> (2) The sale of Shing Wai Company' s business to SW(HK) in around April 1991;
>
> (3) The transfer of business from Din Wai Company to DWE in around September 1991 pursuant to an oral agreement between Ms Ting and Din Wai Company;
>
> (4) The setting up of NWP to share part of SW(HK)' s work load in manufacturing parts;
>
> (5) On about 1 June 1992, the execution of the Master Supply Agreements (' the Supply Agreements') between:
>
> (a) DWE and the taxpayer;
> (b) DWE and SWL;
> (c) DWE and NWP;
>
> Which are deemed to be effective on 1 April 1992;
>
> (6) On about 1 June 1992, the execution of the Representative and Services Agreement (' the Services Agreement') between:
>
> (a) DWE and the taxpayer;
> (b) SWL and the taxpayer;

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9 Decision §163.

(c) NWP and taxpayer;

(7) The transfer of business from SW(HK) to SWL in around April 1993;

(8) The adoption of transfer pricing policy after the transfer of business to the BVI companies which involved:-

(a) the annual exercise of setting the sale price of finished goods from DWE to taxpayer;

(b) the number of goods sold from DWE to taxpayer only recorded in actual quantities of goods ordered and delivered;

(c) the granting of additional bulk discounts from SWL/NWP to DWE after year end."

D.1b The Board's formulation of the Tax Benefit

40. The tax benefit conferred by the Scheme was identified in the following terms:

> "The effect of the Scheme was to reduce the amount of the profits (manufacturing and trading) of the taxpayer by the amounts allocated to DWE and through DWE to SW(HK), NWP and SWL. For the taxpayer, the whole of the profits thus allocated would not be taxable. The Scheme had the effect of conferring a tax benefit on the taxpayer by reason of the reduction in the amount of tax as a result of the allocation."[10]

I shall refer to the tax benefit so formulated as "the Tax Benefit".

41. After considering each of the seven enumerated matters, the Board concluded that the dominant purpose of the taxpayer "and the other participants in the Scheme was to enable the taxpayer to obtain a tax benefit."[11] It therefore concluded that the Commissioner's additional assessments should be confirmed. I shall return later to consider aspects of the Board's approach to the seven matters.

D.2 Reyes J's application of section 61A

42. Reyes J acknowledged that insofar as the manufacturing profits of DWE, SWL and NWP arose offshore, they were not taxable in Hong Kong.[12] However, he upheld the Board's decision on the basis of its finding that the taxpayer had continued to engage in

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10 Decision §179.
11 Decision §213.
12 Judgment §42.

"manufacturing-related activities";[13] its finding that the pricing mechanism operated by the taxpayer and DWE did not result in arm's length prices being paid by the taxpayer; and its finding that this operated to allocate some of Ngai Lik's assessable profits to DWE and that those profits "could be spread around" through the price-setting and the discount arrangement between DWE on the one hand and SW(HK)/SWL and NWP on the other.[14] He also took into account the Board's finding in relation to the agency agreements that the 5% which the taxpayer was entitled to charge thereunder was "not enough to cover even the costs of Ngai Lik's disbursements on behalf of the other companies".

43. His Lordship stated:

> "But for the scheme involving after the fact price-setting by accountants, arbitrary additional discounts and low management fees, Ngai Lik's assessable profits (and thus its liability to profits tax) would have been greater. But for the scheme, Ngai Lik would presumably have been charged a lower price (reflecting market price) for goods supplied by Din Wai Electronic. It would also have earned higher fees for the manufacturing-related services which it provided to the BVI companies."[15]

44. He also concluded that the Board was entitled to reach the view that the dominant purpose of the Scheme was to enable the taxpayer to obtain a tax benefit.

D.3 The Court of Appeal's application of section 61A

45. Le Pichon JA (with whom Stone and Chu JJ agreed) noted[16] that :

> "While all manufacturing work of the group was carried out in the PRC by the 3 BVI companies, the taxpayer had on its payroll a small team of staff who would order materials as agent for Shing Wai and Ngai Wai Plastic, and a team for sourcing materials on behalf of Din Wai Electronics. Purchase orders were prepared and processed in Hong Kong. The taxpayer had a godown for storage of goods and raw materials purchased; if delivered in Hong Kong they would be transported to the Mainland by lorries owned by the group. The taxpayer also made periodic remittances to 'manufacturing subsidiaries' associated local government corporations".

46. On the basis of such matters, she upheld the Board's finding that the taxpayer's "substantial involvement in manufacturing continued" even after the relocation of the group's production facilities to the PRC in 1987, giving rise to a "manufacturing element in the taxpayer's

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13 Judgment §35-37.
14 Judgment §§40 and 41.
15 Judgment §62.
16 Court of Appeal §11.

profits" which she thought was reflected in the taxpayer's financial statements prepared prior to the re-organisation.[17]

47. Her Ladyship's primary focus was however on "the adoption and application of the transfer pricing policy and the derisory level of management fees not to mention their virtual non-payment" as between the taxpayer and DWE. She considered these matters to be "features of the scheme which did not arise from dealings at arm's length [and which] cannot be explained except as a means of minimizing the taxpayer's assessable profits."[18] She held that it was unnecessary for section 61A purposes to quantify the tax benefit but considered such a benefit sufficiently demonstrated by the following facts:

> "While the taxpayer's contribution to the profits of the group dropped from 31.19% in 1991/92 to 7.19% in 1995/96, the profitability of SWHK and the 3 BVI companies rose correspondingly."[19]

48. As to the dominant purpose of the transaction, Le Pichon JA expressed herself in the following terms:

> "The scheme was replete with features designed to enable the taxpayer's assessable profits to be manipulated and shifted offshore to its fellow subsidiaries: at the very heart of the scheme was the free hand to re-write the acquisition cost after the event on an annual basis. Given that the dealings between the taxpayer on the one hand and SWHK and the 3 BVI companies on the other plainly were not dealings at arm's length and the total absence of any commercial or other legitimate reason for the transaction, it is hardly surprising that the Board, having regard to the various matters set out in section 61A(1), came to the conclusion that 'the dominant purpose' of the transaction was to confer a tax benefit on the taxpayer."[20]

E. Issues arising on this appeal

E.1 Deficiencies in the Scheme: discounts received by DWE

49. The Scheme and the Tax Benefit identified by the Commissioner and accepted by the Board are set out above.[21] The central feature of the Tax Benefit as characterised by the Board is that it had the effect of reducing the amount of tax payable by the taxpayer by reducing "the amount of the profits (manufacturing and trading) of the taxpayer by the amounts allocated to DWE and through DWE to SW(HK), NWP and SWL".

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17 Court of Appeal §25. See Table 1 in Section A.1 above for the relevant financial statements.
18 Court of Appeal §29.
19 *Ibid.*
20 Court of Appeal §34.
21 Section D.1.

50. How then does the Scheme as formulated intersect with the Tax Benefit so identified? It is obvious that Items (1) to (7) of the Scheme merely give an account of certain steps taken in the re-organisation of the taxpayer's business. They do not in themselves produce any tax benefit. The Revenue's case depends on Item (8) of the Scheme. The Tax Benefit is said to have been conferred by:

> "The adoption of [a] transfer pricing policy after the transfer of business to the BVI companies which involved:-
>
> (a) the annual exercise of setting the sale price of finished goods from DWE to taxpayer;
>
> (b) the number of goods sold from DWE to taxpayer only recorded in actual quantities of goods ordered and delivered;
>
> (c) the granting of additional bulk discounts from SWL/ NWP to DWE after year end'."

51. However, in my view, Item (8)(c) which concerns the additional annual bulk discounts[22] clearly lacks any connection with the Tax Benefit. As formulated, the Tax Benefit is constituted by the reduction of the taxpayer's profits by "the amounts allocated to DWE". It is therefore the price-fixing mechanism adopted by DWE and the taxpayer which is considered objectionable.[23] The thrust of the Commissioner's complaint is that this mechanism enabled the taxpayer to pay to DWE an inflated price for the finished goods resulting in a corresponding reduction of its assessable profits. Such profits were said to have been "allocated" to DWE in that a corresponding increase in DWE's profits would result.

52. But the additional annual discounts given by SW(HK), SWL and NWP to DWE referred to in Item 8(c) involved different transactions between different parties. They had no impact at all on the taxpayer's profits or its liability to tax. Their effect was (artificially, the Commissioner says) to diminish the profits of SW(HK), SWL and NWP and to swell DWE's profits. They had no connection with the Tax Benefit conferred on the taxpayer by the pricing mechanism and should not have been included in the Scheme.

53. One argument which may have been in contemplation for linking the additional discounts to the Tax Benefit as part of the Scheme involves the suggestion that such discounts were the means by which the taxpayer "allocated" profits to DWE "and through DWE to SW(HK), NWP and SWL", as stated in the Board's formulation. This is echoed in Reyes J's suggestion that "the profits allocated to Din Wai Electronics as a result of the price-setting mechanism could be

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22 See Section A.7 and Table 5 above.

23 Section A.6.

spread around among Shing Wai and Ngai Wai Plastic";[24] and in Le Pichon JA's comment that the scheme "was replete with features designed to enable the taxpayer's assessable profits to be manipulated and shifted offshore to its fellow subsidiaries".[25]

54. But that suggestion is inconsistent with the self-evident effect of the additional discounts as found by the Board. They were discounts given by the other fellow subsidiaries to DWE. They did not involve DWE passing on to them any amounts which ought to have been declared as part of the taxpayer's assessable profits. The flow of finance was in the opposite direction. As noted above, the effect of the additional discounts was to diminish the profits of those other fellow subsidiaries and to augment DWE's profits.

55. Mr Ho SC rightly accepted that Item (8)(c) of the Scheme is irrelevant. Aspects of Items (1) to (7) which address the formation of SW(HK), SWL and NWP and the agreements entered into amongst those companies and as between those companies and DWE are also irrelevant.

E.2 Deficiencies in the Scheme: manufacturing profits

E.2a Reference to manufacturing profits in the Tax Benefit

56. The Tax Benefit contended for by the Commissioner involves the allegation that "the effect of the Scheme was to reduce the amount of the profits (*manufacturing* and trading) of the taxpayer by the amounts allocated to DWE and through DWE to SW(HK), NWP and SWL". The reference to "manufacturing" profits is puzzling to say the least. As mentioned above,[26] Item (8)(a) and (b) can readily be understood to refer to an alleged reduction in the taxpayer's trading profits resulting from the annual price-fixing mechanism. But how is it alleged that the taxpayer had any "manufacturing" profits to "allocate"?

57. Moreover, if the taxpayer did indeed have "manufacturing" profits from some source, the Scheme does not identify any transaction conferring a tax benefit in respect of such profits. The Scheme is only aligned with a tax benefit which involves manipulation of the prices at which DWE sold the finished goods to the taxpayer, affecting the latter's trading profits.

E.2b Assessable manufacturing profits as the basis for upholding the additional assessments

58. However, the reference to "manufacturing profits" is no mere slip of the pen. The Board laid heavy emphasis on the taxpayer earning such profits in Hong Kong and took the view that the additional assessments were justified unless the taxpayer could show that more than 50% of those profits ought to be allocated to its fellow subsidiaries operating on the mainland.

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24 Judgment §41. See Section D.2 above.

25 Court of Appeal §34. See Section D.3 above.

26 Section E.1

59. The Board stated:

> "Prior to the Scheme, manufacturing was part of the taxpayer's business, see the taxpayer's financial statements for the years of assessment 1988/89 – 1990/91. The whole of its profits for 1988/89 and 1989/90 were offered for taxation. It claimed that slightly more than half of its profits for 1990/91 were offshore and were not offered for taxation.
>
> Prior to the Scheme, much was done by the taxpayer to earn the manufacturing profits and the taxpayer did that in Hong Kong.
>
> ...
>
> Since the inception of the Scheme, much was still done by the taxpayer to earn the manufacturing profits allocated to SW(HK) and the three BVI companies and the taxpayer did that in Hong Kong, see the transaction selected by the appellants for illustration purposes."[27]

60. The importance the Board accorded to this view emerges from the following paragraph in its Decision:

> "Unless the taxpayer could make good any claim for apportionment which it might make of more than 50% of the manufacturing profits as offshore profits, the best it could hope for was a 50-50 apportionment under the Revenue's Departmental Interpretation and Practice Notes No 21."[28]

61. The Board's approach therefore relates directly to the manner in which the Commissioner raised the additional assessments, that is, by purporting to treat half of the manufacturing profits of the taxpayer's fellow subsidiaries operating on the mainland as the taxpayer's profits arising in Hong Kong. It is therefore necessary to examine the suggestion that the taxpayer earned such manufacturing profits as a matter of substance.

E.2c Did the taxpayer have any manufacturing profits?

62. That the profits of a business arising offshore are not within the charge to profits tax under section 14 of the Ordinance is well-established and not in dispute.[29] This remains the

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27 Decision §§174, 175 and 177. The illustration is discussed in Section E.2c below.

28 Decision §178.

29 Section 14(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

position where the taxpayer carries on a business in Hong Kong so long as the profits in question derive from its operations abroad. As Lord Bridge of Harwich noted in *CIR v Hang Seng Bank Ltd*:[30]

> "... the structure of the section presupposes that the profits of a business carried on in Hong Kong may accrue from different sources, some located within Hong Kong, others overseas. The former are taxable, the latter are not."

63. As his Lordship pointed out, the taxpayer may ensure that the local and offshore businesses are clearly separated "by ensuring that the separate business of his overseas branch was carried out by a different company or subsidiary company."[31] This should be borne in mind when considering the respective activities of the taxpayer in Hong Kong and its fellow subsidiaries on the mainland.

64. It is not disputed that in 1987, the taxpayer moved its production to factories on the mainland. As we have seen, since the re-organisation, the manufacturing businesses were operated by DWE, SW(HK)/SWL and NWP in factories in Shenzhen and Dongguan in conjunction with mainland enterprises. The finished products were then sold by DWE to the taxpayer whose profits derived from on-selling those products to its own customers. It therefore cannot be in doubt that the relevant manufacturing processes took place outside of Hong Kong. Even if they were part of the taxpayer's own business, the profits deriving from those operations would not be chargeable to Hong Kong profits tax since they would have been sourced offshore. Moreover, it is clear that those operations and those profits were not those of the taxpayer, but of its fellow subsidiaries. Such profits did not fall within the section 14 charge to tax.

65. Why then does the Board formulate the Tax Benefit in terms of the taxpayer having manufacturing profits? An examination of its Decision shows that the Board's focus was on the taxpayer's activities in connection with sourcing raw materials for use by its fellow subsidiaries in the manufacturing process and in connection with other agency services provided. I shall refer to these activities as the "sourcing and agency activities".

66. The Board evidently thought that the taxpayer's involvement in the sourcing and agency activities meant that it continued to have a manufacturing business and that only half of the profits of such business should be treated as arising offshore. Thus, the Board equated the taxpayer's sourcing and agency activities with an "*involvement in manufacturing*" as the following passages (with italics supplied) indicate:

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trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part."

30 [1991] 1 AC 306 at 318.

31 At 318-319.

> "The taxpayer's substantial *involvement in manufacturing* continued. This is clear from the transaction selected by the appellants for illustration purposes. The taxpayer also maintained a 'small' team for ordering materials as agent for NWP and SWL and a 'team' for sourcing materials on behalf of DWE and staff of the two teams were under the payroll of the taxpayer. Upon request from DWE, NWP and SWL in the Mainland, the taxpayer's staff in Hong Kong placed orders for raw materials with Hong Kong suppliers. The purchase orders were prepared and processed in Hong Kong. The goods were delivered in Hong Kong or directly to the Mainland and there was a godown in the Hong Kong office of the taxpayer for storage of goods. The taxpayer made periodic Hong Kong dollar remittances to 'the manufacturing subsidiaries' associated local government corporations'."[32]
>
> "Under the three Representative and Services Agreements made with DWE, NWP and SWL, the taxpayer was entitled to a remuneration of 5% of the expenses incurred. 5% might not even cover cost of funds for the disbursements. Two sourcing teams were on the taxpayer's payroll and despite the taxpayer's *substantial involvement in manufacturing*, the taxpayer received no management fee except for the 1992/93 year of assessment, $1,450,000 from DWE, $350,000 from SW(HK), and $200,000 from NWP. No explanation has been offered for the absence of management fees. Needless to say, the lesser the management fee, the lesser the amount of taxable profits for the taxpayer."[33]
>
> "Despite its *substantial role in the manufacturing process*, the taxpayer received nothing for its role except for the 1992/93 year of assessment during which it received $1,450,000 from DWE, $350,000 from SW(HK), and $200,000 from NWP. By allocating the taxpayer's profits to SW(HK) and the three BVI companies, the taxpayer's profits and tax liability dropped."[34]

67. I would add in parenthesis that the references to the illustrative transaction as something which shows that the taxpayer continued to be involved in manufacturing is odd since the illustration does nothing of the sort. As the relevant paragraph[35] itself makes clear, the illustration sets out a list of "documents relating to a *trading* transaction" starting with a purchase order from a Hong Kong customer to the taxpayer and ending with a bill of lading showing Hong Kong as the port of loading.

E.2d The irrelevance of the taxpayer's sourcing and agency activities

68. I am, with respect, unable to see how any profits derived from the taxpayer's sourcing and agency activities can properly be described as manufacturing profits or used as a basis for

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32 Decision §187.
33 Decision §192.
34 Decision §200.
35 Decision §110.

treating part of the fellow subsidiaries' profits as the taxpayer's profits. The manufacturing operations of the former companies were obviously quite distinct from the taxpayer's sourcing and agency activities and were wholly conducted offshore. Even if the latter activities can be properly described as "involving manufacturing" or as Reyes J puts it as "manufacturing-related activities", they were at most ancillary and incidental to the offshore manufacturing operations which actually produced "manufacturing profits" which arose only upon disposal of the manufactured goods. As was pointed out in this Court, such incidental activities do not provide the basis for locating profits in Hong Kong. The focus must be :

> "... on establishing the geographical location of the taxpayer's profit-producing transactions themselves as distinct from activities antecedent or incidental to those transactions. Such antecedent activities will often be commercially essential to the operations and profitability of the taxpayer's business, but they do not provide the legal test for ascertaining the geographical source of profits for the purposes of section 14."[36]

69. The sourcing and agency activities in Hong Kong might, of course, give rise to assessable profits. Many companies specialise in sourcing suppliers for manufacturers and charge a commission or receive some other remuneration for the service. Indeed, it was envisaged that the taxpayer would be remunerated for such services pursuant to the representative and service agreements. The implementation of those agreements attracted criticism from the Board and the courts below on the ground that the agreed rate of remuneration – 5% of expenses – was, in Le Pichon JA's words, [37] set at a "derisory level" and because, as Table 4[38] shows, such remuneration was often left unpaid.

70. One can well see the basis for those criticisms. However, the underpayment of management and service fees is not a matter identified either as part of the Scheme or as part of the Tax Benefit. Nor is the Commissioner's assessment directed at nullifying or counteracting any tax benefit allegedly obtained by the taxpayer undercharging for its sourcing and agency services.

71. Accordingly, the various references by the Board and the courts below to manufacturing profits or profits from "manufacturing-related activities" are wide of the mark. They cannot provide any foundation for the additional assessments and are irrelevant to the proper application of section 61A in the present case.

E.3 Deficiencies in the Scheme: the relevant years of assessment

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36 *ING Baring Securities (Hong Kong) Limited v CIR* (2007) 10 HKCFAR 417 at 435-436. See also *Kwong Mile Services Ltd v Commissioner of Inland Revenue* (2004) 7 HKCFAR 275 at 283.

37 Court of Appeal §29. See Section D.3.

38 Section A.5 above.

72. For section 61A to apply, there must be a transaction or scheme which has the effect of conferring a tax benefit on the taxpayer. It follows that until the scheme comes into being, there is nothing which can confer any tax benefit and so no basis for the section's operation.

73. Having listed as Items (2) and (3) the transfers of the businesses of the sole proprietorships to SW(HK) and DWE, the Scheme went on in Item (7) to list the transfer of business from SW(HK) to SWL (which is of course a BVI company) "in around April 1993". As we have seen, Item (8)(a) and (b), which is the operative part of the Scheme, identifies the relevant transaction or scheme as "the adoption of the transfer pricing policy" in combination with the practice of recording only the quantities of goods ordered and delivered. But the important point to notice is that Item (8) states that the adoption of this policy took place "after the transfer of business to the BVI companies" which necessarily means that the objectionable transaction only came into existence after April 1993.

74. It must follow that no scheme was alleged to have been in existence capable of affecting the taxpayer's liability during the 1991/92 and 1992/93 years of assessment. The Revenue's case can therefore only apply, if at all, to the three subsequent years of assessment.

75. Mr Ho invited the Court to read the Scheme's reference to "the BVI companies" as including reference to SW(HK), a Hong Kong company, since this accords with a definition he had used in his written submissions to the Board. I cannot see how such a reading can be adopted. But in any event, such a reading would not assist him. The Scheme undoubtedly includes as one of the instances when a business was transferred to a BVI company, the transfer of SW(HK)'s business to SWL in April 1993. That transfer is obviously embraced by the words "after the transfer of business to the BVI companies" and that does not change even if that phrase is understood also to cover the earlier transfer of business by Shing Wai Company to SW(HK).

E.4 Are the Scheme and the Tax Benefit still a viable basis for section 61A assessments?

76. The foregoing discussion leads to the conclusion that the Scheme and Tax Benefit as formulated by the Board suffer from three serious deficiencies. First, Item (8)(c) of the Scheme relating to the annual discounts given by SWL and NWP to DWE is irrelevant. Secondly, there is no basis for including manufacturing profits as part of the taxpayer's profits – whether in terms of profits deriving from the taxpayer engaging in manufacturing in Hong Kong, or of having passed along profits "allocated" to DWE to the fellow subsidiaries engaged in manufacturing on the mainland or as the profits of the taxpayer's sourcing and agency activities in Hong Kong. Thirdly, the Scheme is chronologically incapable of affecting the taxpayer's profits for the years 1991/92 and 1992/93.

77. Two questions accordingly arise: Is there a conceptually viable section 61A scheme if these deficiencies are stripped away from the Board's formulation of the Scheme and the Tax

Benefit? Is the Commissioner permitted as a matter of law to proceed on the basis of a pared-down scheme?

78. In my view, the answer to the first question is "Yes". One can notionally "amend" (i) the Scheme by deleting every Item except Item (8)(a) and (b); and (ii) the Tax Benefit by deleting all reference to manufacturing profits and to "allocation" of profits "through DWE to SW(HK), NWP and SWL". This would leave the contention – which was always at the heart of the case – that the price-fixing arrangement with DWE had the effect of conferring on the taxpayer a tax benefit involving a reduction of its assessable profits.

79. In response to the second question, it is my opinion that such a notional "amendment" is permissible provided (i) that the stripped down scheme and tax benefit are consistent with the Board's findings and correspond to the statutory definitions of those concepts; and (ii) that permitting the Commissioner to proceed on such a notionally amended basis causes no procedural or other unfairness to the taxpayer.

80. The Australian High Court's decision in *Federal Commissioner of Taxation of the Commonwealth of Australia v Peabody*[39] is relevant and helpful in this context. The Court[40] there held when dealing with the applicable anti-avoidance provisions that:[41]

> "... the Commissioner is entitled to put his case in alternative ways. If, within a wider scheme which has been identified, the Commissioner seeks also to rely upon a narrower scheme as meeting the requirements of Pt IVA, then in our view there is no reason why the Commissioner should not be permitted to do so, provided it causes no undue embarrassment or surprise to the other side."[42]

81. A degree of support for this approach to section 61A may be derived from section 61A(2)(a)[43] which permits the Commissioner to fashion her assessment as a response to "any part of" a transaction caught by the provision, which suggests that she can ignore irrelevant parts.

82. Mr Barlow sought to distinguish *Peabody* on the footing that in the Australian legislation, provision was made for serving particulars of the scheme relied on and for amendments to be made to such particulars. I do not think such procedural differences affect the question of substance. If there is a viable basis for establishing a scheme which has the effect of conferring a tax benefit within the meaning of the Ordinance, the Commissioner should be permitted to proceed on that basis notwithstanding what may have been earlier misconceptions on her part – provided always that procedural fairness to the taxpayer can be assured.

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39 (1993-94) 181 CLR 359.

40 Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ.

41 In Part IVA of the Income Tax Assessment Act 1936 (Cth).

42 At 382.

43 Set out in Section C. above.

83. A notional amendment causes no procedural unfairness in the present case. This judgment will therefore proceed on the basis of a narrower scheme confined to Item (8)(a) and (b) and a narrower tax benefit (confined to the taxpayer's trading profits and ignoring references to profits passed on to fellow subsidiaries) and will refer to these as "the Narrower Scheme" and "the Narrower Tax Benefit" respectively.

F. Is there a "tax benefit" within the meaning of section 61A?

84. Mr Barlow contends that even if the earlier irrelevancies are stripped away, there is no "tax benefit" within the meaning of section 61A.

85. His argument runs along the following lines:-

(a) The tax benefit in the present case involves the Commissioner's allegation that the price-fixing arrangement enabled gratuitous overpayments to be made to DWE and so enabled the taxpayer to overstate the cost of acquiring the finished products from DWE and therefore to make unjustified deductions against the profits arising from their on-sale to customers. The taxpayer's assessable profits were therefore under-stated and properly chargeable taxes were avoided.

(b) Assuming that to have been the case, the Commissioner's remedy, he argues, was to disallow those deductions as falling foul of section 16 which only permits the deduction of outgoings and expenses "to the extent to which they are incurred ... in the production of profits in respect of which he is chargeable";[44] and of section 17 which excludes deductions of "any disbursements or expenses not being money expended for the purpose of producing such profits".[45] Although the Commissioner mentioned sections 16 and 61 in making the additional assessments, she in fact proceeded under section 61A and Mr Ho relies on no other section.

(c) However, so the argument runs, impermissible deductions cannot found an assessment under section 61A because, on the true construction of "tax benefit" as defined in subsection (3), such deductions cannot constitute a "tax benefit".

(d) Section 61A(3) defines "tax benefit" as "the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof". Mr Barlow submits that this means that a "tax benefit" only comes into being where the taxpayer's "liability to pay tax" can be said upon an accurate legal analysis to have been

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44 Section 16(1) of the Ordinance.

45 Section 17(1)(b) of the Ordinance.

avoided, postponed or reduced. It is a fall-back power to be used only where the Revenue is confronted with a scheme which has successfully altered the taxpayer's legal liability but which is objectionable because its sole or dominant purpose is the avoidance of tax.

(e) In the present case, he argues, an impermissible deduction does not affect the taxpayer's "liability to pay tax": it continued to be liable to pay tax on properly computed profits free of impermissible deductions. Thus, he concludes, neither the Tax Benefit nor the Narrower Tax Benefit is capable of triggering section 61A and the additional assessments are invalid.

86. Mr Barlow advanced as the premise of his argument the proposition that the relevant tax benefit involves "gratuitous payments" by the taxpayer which resulted in impermissible deductions from its outgoings which could and should have been disallowed under sections 16 and 17 of the Ordinance. It is on that basis that he contends that the taxpayer's liability to pay tax remained unaltered by the price-fixing arrangement and that section 61A was accordingly not engaged. In my view, it is a premise which has not been made out.

87. In the first place, I cannot accept the description of the taxpayer's payments as "gratuitous". As the Board found, and indeed, as appears from its formulation of the Scheme, the payments were made in return for goods ordered and delivered. The Board found that the taxpayer's purchases from DWE were not made in accordance with the master supply agreement, but the taxpayer was obviously obliged to pay for the goods it had been receiving and then on-selling in the course of the year. In the absence of evidence to the contrary, it must be assumed that the parties had agreed, whether expressly or by conduct, to vary the master supply agreement so that the prices would be fixed at year's end and that the taxpayer would make payment accordingly.

88. Secondly, I do not accept that the proper analysis is to view such payments as involving impermissible deductions. What the Board found objectionable was the fact that the purchase prices were not fixed at arm's length. That is a matter highly relevant in the section 61A context, but it does not follow that the fact that excessive prices were paid meant that section 17 should be triggered and deduction disallowed.

89. Section 16(1) provides that in the computation of profits 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 ..."

And under section 17(1)(b):

> "no deduction shall be allowed in respect of ... any disbursements or expenses not being money expended for the purpose of producing such profits..."

90. Plainly, the taxpayer had to incur the payments to DWE if it was to have goods to on-sell to its customers. The payments were therefore incurred for the purpose of producing its profits. It was therefore entitled under section 16 to deduct "all outgoings and expenses" to the extent incurred during the relevant basis period. And the sums paid could not be said to be "expenses not being money expended for the purpose of producing … profits" so as to be excluded by section 17(1)(b).

91. When asked in the course of argument whether it was open to the Commissioner to disallow a deduction on the basis that a price paid was not reasonable, Mr Barlow answered, in my view correctly, that it was not. Sections 16(1) and 17(1)(b) do not require the Commissioner to compare the purchase prices deducted against market prices and to disallow deductions considered excessive. If incurred in the production of the taxpayer's profits, all outgoings and expenses are deductible according to section 16(1). Unless it can be said of a specific amount that it is not money expended for the purpose of producing the taxpayer's profits, section 17(1)(b) does not bite.

92. Accordingly, on the Board's findings, the taxpayer's payments made pursuant to the Narrower Scheme *were* in my view deductible outgoings. The taxpayer *did* therefore successfully alter its legal liability to pay tax in that the Narrower Scheme enabled it to make those deductions which, but for section 61A, would have the effect of conferring a tax benefit on the taxpayer. Section 61A is therefore engaged, even on the assumption that Mr Barlow's argument as to the construction of the term "tax benefit" is correct.

93. In the light of the foregoing conclusion, it is unnecessary to decide whether that construction is indeed correct and I wish expressly to leave that question open, particularly since the Court did not have the benefit of full argument from the Commissioner. I will for present purposes confine myself to some comments on submissions made concerning two earlier decisions of this Court, namely, *CIR v HIT Finance Ltd,*[46] and *CIR v Tai Hing Cotton Mill (Development) Ltd.*[47]

94. Mr Barlow sought to rely on *CIR v HIT Finance Ltd,*[48] in support of his construction argument. That was a case in which a scheme which involved the taxpayer borrowing a very substantial sum of money and introducing into the group transaction an offshore company as a means of immediately returning two-thirds of the sum borrowed was held to have been entered into for the dominant purpose of the taxpayer obtaining a tax benefit by being able to deduct interest

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46 (2007) 10 HKCFAR 717.
47 (2007) 10 HKCFAR 704.
48 (2007) 10 HKCFAR 717.

payments on the excess amount borrowed. Mr Barlow endeavoured to argue that Lord Hoffmann's analysis of whether such deduction could have been disallowed under sections 16 and 17 and his conclusion that it could not, show that this was a case where the scheme had resulted in the alteration of the taxpayer's legal liability to pay tax in that it had resulted in a permissible deduction; and that this was a necessary preliminary to considering whether the scheme could be challenged under section 61A.

95. In my view, CIR v HIT Finance is not authority for those propositions. The reality is that the line of argument under discussion was neither advanced before nor addressed by the Court. One should therefore not read too much into that decision in the present context. There are aspects of Lord Hoffmann's judgment which might be thought to militate against Mr Barlow's construction argument. Thus, Lord Hoffmann prefaced his discussion of the position under sections 16 and 17 by saying: "In view of the conclusion which I have reached on s 61A, it is strictly unnecessary for me to say anything about ss16 and 17."[49] It could obviously be argued that if Mr Barlow were right, it would have been strictly necessary for his Lordship to satisfy himself that the deduction could not be disallowed under those sections before proceeding to apply section 61A.

96. On the other hand, in both of these cases, Lord Hoffmann's approach to what constitutes a "tax benefit" may well be thought to be consistent with the construction argument discussed above. Thus, in CIR v Tai Hing he stressed the need to compare the effect of the transaction on the taxpayer's liability to tax against his tax liability computed on some other basis, stating:

> "In my opinion however, s 61A raises a straightforward question of causation and comparison. If the effect of the transaction is that your liability to tax is less than it would have been on some other appropriate hypothesis, you have had a tax benefit. Provided that the calculation is properly done, the section is not concerned with how the elements of the calculation are categorised for other purposes of tax law."[50]

And in *CIR v HIT Finance*, he similarly explained:

> "A tax benefit simply means a difference favourable to the taxpayer between his tax liability computed on one basis and his liability computed on a different basis. It does not mean any particular element in that computation."[51]

97. Those two decisions therefore have not settled the construction question which I have left open. Until the point is authoritatively determined after proper argument and indeed, in any event, in cases where the Commissioner seeks to challenge excessive expenditure resulting in reduced assessable profits, she should mount the challenge on alternative bases under sections 16,

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49 At 726, §15.
50 At 712, §14.
51 At 727, §17.

17, 60 and 61A insofar as these provisions may be applicable. That is the course initially adopted by the Commissioner in the present case but reliance on the other sections was later abandoned and the case proceeded solely on the basis of section 61A. The Court was not told why that was done and neither party addressed the question of whether and, if so when, the possibility of an additional assessment under section 60 became time-barred, a point which would have been relevant if it had been necessary to determine the construction argument.

G. The dominant purpose of the Narrower Scheme

98. I turn therefore to the next question, namely whether, having regard to the matters set out in section 61A(1), it ought objectively to be concluded that the taxpayer and DWE entered into the price-fixing arrangement with the sole or dominant purpose of obtaining a tax benefit for the taxpayer.

G.1 Preliminary comments on the seven matters

99. Certain preliminary comments may be made in relation to the matters listed in section 61A(1)(a) to (g) (set out in Section C above).

(a) It appears to me that there is a qualitative difference between the first three items and the four remaining matters. The matters in paragraphs (a), (b) and (c) give guidance on methodology – guidance as to how the facts are to be approached in addressing the question of dominant purpose; while paragraphs (d) to (g) point to certain classes of fact as possible signposts to the requisite dominant purpose.

(b) Thus, paragraph (a) tells us that it is permissible to look at the genesis of the transaction and also at the actual manner of its implementation. We are not confined simply to the features of the scheme itself or simply to its terms as set out on paper.

(c) Paragraph (b) indicates that one is entitled to look beyond the form and at the substance of the transaction, making it plain, for instance, that approaches such as that of Lord Tomlin in *IRC v Duke of Westminster*,[52] confining the court to the legal forms has no place in the section 61A regime. This was a point made by the High Court of Australia in the context of similar Australian legislation in *Commissioner of Taxation of the Commonwealth of Australia v Spotless Services Limited*.[53] Clearly, paragraph (b) overlaps with the other paragraphs as one is in each case looking at the substance and not just the form of the relevant arrangement.

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52 [1936] AC 1 at 19.

53 (1996) 186 CLR 404 at 414, per Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ.

(d) Paragraph (c) requires the fiscal effects of the overall transaction to be assessed, a matter closely overlapping with the anterior requirement of being satisfied that the scheme had the effect of conferring a tax benefit on the taxpayer.

(e) Paragraphs (d) and (e) require us to look at the financial effects of the particular scheme on the taxpayer and also on persons connected with the taxpayer, such as the group to which a taxpayer company belongs. It may be highly significant under paragraph (d) that the scheme brings about *no* changes to the taxpayer's financial position while at the same time producing a tax benefit. Or, under paragraph (e), it may be significant that the scheme involves transactions among group members resulting in an unchanged financial position for the group as a whole but in the conferment of a tax benefit on the taxpayer. As Lord Nolan pointed out in *IRC v Willoughby*:[54]

"The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option."

(f) Similarly, the fact that the scheme incorporates dealings which are not at arm's length may (as paragraph (f) indicates) be an important signpost since commercial dealings are normally conducted at arm's length and the uncommercial features of a transaction may suggest that it was entered into with the dominant purpose of producing a tax benefit for the taxpayer.

(g) The participation of an offshore corporation in the transaction (mentioned in paragraph (g)) might be a pointer to the requisite dominant purpose because it may indicate an attempt to exploit for tax avoidance purposes, the source requirement in the charging provisions of section 14.

100. The foregoing comments on the seven matters listed in section 61A are obviously not in any way intended to be comprehensive or exhaustive. I seek merely to emphasise the need to approach those matters qualitatively with a feel for the particular circumstances of each case. While it is necessary to have regard to each of the seven matters, this does not mean that they should be approached as boxes to be mechanically ticked off in every single case, an approach which has sometimes led to inapt attempts to force the facts into one pigeon-hole or other.

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54 [1997] 1 WLR 1071 at 1079.

G.2 The Board's approach

101. The Board laid heavy emphasis on paragraph (a), namely on "the manner in which the transaction was entered into or carried out". It regarded the advice given by E&Y as representing the manner in which the transaction was entered into. It thought the object of such advice was to obtain a tax benefit for the taxpayer. In a sense that is obviously correct: E&Y were advising on measures to keep separate the Hong Kong-based operations and the offshore activities in order to segregate taxable from non-taxable profits. However, the statutory purpose of section 61A is not to attack arrangements made to secure tax benefits which are legislatively intended to be available to the taxpayer. As noted above, our system of taxation does not bring within the section 14 charge to tax profits which arise from operations conducted offshore, whether by the taxpayer or by a fellow subsidiary. Passages in support taken from the speech of Lord Bridge in the *Hang Seng Bank* case have been cited above.[55] And as Lord Nolan pointed out in *IRC v Willoughby*:[56]

> "... it would be absurd in the context of [the relevant anti-avoidance legislation] to describe as tax avoidance the acceptance of an offer of freedom from tax which Parliament has deliberately made. Tax avoidance within the meaning of s 741 is a course designed to conflict with or defeat the evident intention of Parliament."

102. The E&Y advice did not relate to the Narrower Scheme. It never suggested any annual price-fixing arrangement between DWE and the taxpayer. On the contrary, it advised that there should be a master supply agreement with a 10% price margin over the cost of purchasing from the cheapest alternative supplier. The E&Y advice was therefore not relevant to paragraph (a).

103. The Board considered the manner in which the transaction was carried out to be highly significant not merely under paragraph (a) but also under most of the other six paragraphs because it thought the taxpayer continued to have a substantial involvement in manufacturing;[57] engaged in the onward "allocation" of profits to SW(HK), SWL and NWP via the system of additional annual discounts;[58] and failed to charge enough for its sourcing and agency activities.[59] For the reasons given in Sections E.1 and E.2 of this judgment, I consider those conclusions misdirected.

G.3 The dominant purpose of the Narrower Scheme

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55 Section E.2c.

56 [1997] 1 WLR 1071 at 1079.

57 Decision §§187-189, 200, 205.

58 Decision §§191,197, 207.

59 Decision §§192, 200, 205.

104. The Board did, however, also make findings in relation to paragraph (f) (non-arm's length transactions) which are properly relevant to the Narrower Scheme and the Narrower Tax Benefit. It stated:

> "Under the Master Supply and Requirements Agreement made between the taxpayer and DWE for the supply by DWE to the taxpayer of audio products, the taxpayer should purchase from DWE unless the landed cost of each delivery exceeded by more than 10% of the costs of an alternative supplier or unless DWE was unable to supply the quantity or quality required. However, that was not the way it was carried out. Purchases and sales between the two companies were only recorded in actual quantities of goods ordered and delivered. According to Mr Lam, the price sold by DWE to the taxpayer was decided not by him, but by the 'accounting department'. This points to manipulation of the amount of profits to be transferred from the taxpayer to DWE."[60]

> "Although DWE was contractually entitled to charge the taxpayer up to 10% more than the cheapest alternative supplier, the sale and purchase price was not decided unless and until it was decided by the 'accounting department' on an annual basis. This is not dealing on arms-length basis."[61]

105. Also relevant is the Board's finding that :

> "while the taxpayer's turnover represented the Group's turnover, the taxpayer's profits dropped and its contribution to the profits of the Group dropped from 31.19% in 1991/92 to 7.19% in 1995/96 ..."[62]

106. In my view, the Board was entitled to make those findings and to hold that they provide a proper basis for concluding that the price-fixing arrangement was entered into with DWE for the dominant purpose of obtaining a tax benefit for the taxpayer.

107. Paragraphs (d), (e) and (f) of section 61A(1) are of particular importance to that conclusion and none of the other listed matters detract from it. It is clear that DWE and the taxpayer were not dealing with each other at arm's length. Although they had entered into an ostensibly binding master agreement that required DWE's prices to be scrutinised against competing supplier's prices, that agreement was superseded by the price-fixing arrangement. The prices at which DWE sold the finished audio products to the taxpayer were determined by the taxpayer's accounting department as an intra-group arrangement at the end of each year.

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60 Decision §190.
61 Decision §206.
62 Decision §195.

108. The change in the taxpayer's financial position that resulted from the price-fixing arrangement was that its profits were reduced to the extent that DWE's price was inflated. That was of course the basis of the tax benefit obtained. Unfortunately, the quantification of the extent to which the price was inflated was not explored by the Board.

109. However, when one asks what change was caused by the Narrower Scheme to the financial position of the Group (which consisted of companies who had a connection with the taxpayer within the meaning of paragraph (e)) the answer, significantly, is "None". The Group's turnover was the taxpayer's turnover, it being the group company which traded with external customers. That turnover increased over the years of assessment in question as noted in Table 2, rising (in rough figures) from $454 million in 1991/92; to $611 million in 1992/93; to $800 million in 1993/94; to $875 million in 1994/95 and to $1,089 million in 1995/96. Yet, as the Board found, the taxpayer's contribution to Group profits fell from 31.19% in 1991/92 to 7.19% in 1995/96. This plainly suggests that profits were being diverted by the Narrower Scheme away from the taxpayer.

110. When one asks why the parties entered into the price-fixing arrangement which resulted in group profits being passed from one pocket to another, the irresistible conclusion is that this was done with the dominant purpose of obtaining a tax benefit for the taxpayer.

111. It is therefore my view that section 61A was engaged – but only in relation to the three tax years from 1993/94 to 1995/96[63] – and that by virtue of section 61A(2), the Commissioner became bound to assess the taxpayer's liability to tax. That is, however, not the end of the discussion since it is contended by Mr Barlow that the Commissioner misapplied her powers in raising the relevant additional assessments.

H. The power of assessment under section 61A(2)

H.1 Exercise of the power for its proper purposes

112. Once it is established that section 61A(1) applies, the Commissioner comes under a duty to raise an assessment in accordance with the provisions of section 61A(2). As Lord Hoffmann explained in *CIR v Tai Hing*,[64] the Commissioner has two options on how to proceed:

> "Paragraph (a) says that she may assess the taxpayer as if the transaction had not been entered into or carried out. ... But she may also, under para (b), assess the taxpayer in such other manner as she considers appropriate 'to counteract the tax benefit which would otherwise be obtained'. The hypothesis of an assessment under (b) must therefore be, not only that the actual transaction did not take place, but that some other transaction took place instead. Otherwise (b) would add nothing to (a)."

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63 For the reason given in Section E.3 above.

64 (2007) 10 HKCFAR 704 at 713, §17.

113. Option (a) is relatively straightforward: the taxpayer is assessed as if the transaction had not been entered into or carried out. But if option (b) is chosen, the assessment must be designed "to counteract the tax benefit which would otherwise be obtained". The power must therefore be exercised on the basis of a reasonably postulated hypothetical transaction which produces an assessment designed rationally to counteract the tax benefit. The assessment cannot be raised in some arbitrary amount or arrived at upon some basis that is unreasonable or not rationally related to the tax benefit in question. Such an assessment would not be a proper exercise of the power conferred by section 61A(2).

114. Thus, in *CIR v Tai Hing*, commenting on the Commissioner's power under section 61A(2), Lord Hoffmann stated:

> "She would not be entitled, as the more alarmist submissions of counsel for the taxpayer suggested, to make an assessment on the hypothesis that the taxpayer had entered into an alternative transaction which attracted the highest rate of tax. That would not be a reasonable exercise of the power. But she may adopt the hypothesis which the evidence suggests was most likely to have been the transaction if the taxpayer had not been able to secure the tax benefit."[65]

115. And in *CIR v HIT Finance*,[66] his Lordship stated:

> "... the Board found, and was entitled to find, that borrowing the larger amount and introducing Strategic as the means of returning two-thirds of it to PAL conferred a tax benefit and that the transaction was in that respect entered into solely or predominantly for the purpose of obtaining that benefit. The Commissioner was therefore entitled to take appropriate steps to counteract that benefit. She fully achieved that object by disallowing the deduction of interest on the borrowing of HITL from Finance in excess of the net proceeds of the loan note issue actually received by the group. Any disallowance of deductions by Finance as well would go further than counteracting the tax benefit and would not in my opinion be appropriate."

H.2 The Commissioner's exercise of the section 61A(2) power

116. The exercise of the section 61A(2) power has seriously miscarried in the present case. As pointed out in Section B and Tables 7 and 8 above, the additional assessments purported to treat the whole of the profits of SW(HK) and the three BVI companies as the taxpayer's chargeable profits. Subsequently, those assessments were reduced by 50%. But they remained, of

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65 *Ibid* at 714, §21

66 (2007) 10 HKCFAR 717 at 729, §23.

course, assessments which treated half of the profits of the taxpayer's fellow subsidiaries operating on the mainland as the taxpayer's assessable profits in Hong Kong.

117. It is evident that those additional assessments were not based on option (a) discussed above. They were not raised on the basis that the price-fixing arrangements had not been entered into or carried out. Although the language she used in her Determinations of 26 June 2000[67] tends to reflect the content of sections 16 and 17, the Commissioner was evidently purporting to exercise the power under option (b) with a view to counteracting the tax benefit in question. In other words, she was purportedly seeking to counteract non-arm's length transactions which had resulted in the reduction of the taxpayer's assessable profits.

118. But it is impossible to understand how that objective was advanced by the additional assessments raised. To counteract that tax benefit a reasonable approach which obviously recommends itself would have been to raise an assessment on the profits which would hypothetically have been earned if the taxpayer had purchased the goods at arm's length prices instead of at the prices fixed annually.

119. Instead, the Commissioner raised an assessment on 50% of the profits derived by the taxpayer's fellow subsidiaries from their manufacturing operations on the mainland. It is, with respect, impossible to see any rational connection between that figure and the excessive prices allegedly paid by the taxpayer to DWE. The additional assessments raised do not counteract the relevant tax benefit.

120. It appears that the Commissioner adopted that 50% figure simply on the basis of the Revenue's practice regarding the apportionment of profits attributable to offshore manufacturing operations in certain cases.[68] But the question whether the Commissioner properly exercised her section 61A(2) powers in raising the additional assessments is a question of law to which the Revenue's practice does not provide an answer. When asked to explain the basis of the figures adopted in those assessments, Mr Ho frankly stated that the figure was arbitrary. As Mr Barlow correctly submitted, the Ordinance does not authorise arbitrary assessments to be made under section 61A(2).

121. Mr Ho submitted that it was not for the Commissioner to justify the assessments made but for the taxpayer to discharge the onus of showing that the additional assessments were excessive or incorrect pursuant to section 68(4) of the Ordinance. Where as in the present case, the exercise of the Commissioner's power is shown to have miscarried, that onus is discharged.

H.3 The Board's approach to the exercise of the section 61A(2) power

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67 Section B above.

68 Referred to in its Departmental Interpretation and Practice Notes No. 21 (Revised 1998) on the Locality of Profits, §22.

122. The Board's approach to the exercise of the power is, with respect, untenable. It appears to have interpreted the additional assessments as having been levied under section 61A(2)(a) rather than (b) and held them to be justified as follows:

> "Under section 61A(2), liability to tax shall be assessed 'as if the transaction or any part thereof had not been entered into or carried out'.
>
> If the Scheme had not been entered into or carried out, the taxpayer would have carried out manufacturing business in its own right. The taxpayer has at all material times been carrying on business in Hong Kong. Its profits, including manufacturing and trading profits, were from the business carried on by the taxpayer in Hong Kong. The taxpayer's manufacturing activities were clearly not wholly offshore, see the transaction selected by the appellants for illustration purposes. The taxpayer had not made any claim for apportionment and had not made good any claim for apportionment of more than 50% of the manufacturing profits as offshore profits, the onus being on the taxpayer to prove that the assessments appealed against were incorrect or excessive."[69]

123. This harks back to the Board's view (noted in Section E.2b above) that:

> "Unless the taxpayer could make good any claim for apportionment which it might make of more than 50% of the manufacturing profits as offshore profits, the best it could hope for was a 50-50 apportionment under the Revenue's Departmental Interpretation and Practice Notes No 21."[70]

124. The Board therefore upheld the additional assessments on the basis that (i) the taxpayer was carrying on business in Hong Kong producing manufacturing profits which were assessable here since they were "not wholly offshore"; and (ii) that it was appropriate to apply the Revenue's Practice Notes to fix the assessment at 50% of the combined profits of SW(HK), SWL, NWP and DWE.

125. For the reasons given in Section E.2 of this judgment, it is my view that no basis exists for treating any share of the manufacturing profits of the fellow subsidiaries as the taxpayer's assessable profits. Nor is the Practice Note of any relevance. The additional assessments must be justified upon a proper application of the section and not by reference to administrative practices adopted by the Revenue. There is a clear mismatch between the Board's approach and the content of the scheme and tax benefit which engages section 61A. An assessment seeking to charge the taxpayer with half of the manufacturing profits of the four fellow subsidiaries does not rationally address or seek to counteract the tax benefit arising from the price-fixing arrangement between the taxpayer and DWE.

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69 Decision §§216 and 217.

70 Decision §178.

126. Neither Reyes J nor the Court of Appeal dealt with the validity of the Commissioner's exercise of the section 61A(2) power.

I. Disposal of the Appeal

127. It follows from the foregoing that the additional assessments were not validly raised. What should now happen? Should there be an order requiring a proper section 61A assessment to be made?

I.1 The power to annul and remit

128. Where a Board of Review determines an appeal it may, under section 68(8)(a) of the Ordinance, confirm, reduce, increase or annul the assessment appealed from or "remit the case of the Commissioner with the opinion of the Board thereon". Section 68(8)(b) requires the Commissioner on such a remitter to "revise the assessment as the opinion of the Board may require and in accordance with such directions (if any) as the Board ... may give concerning the revision required in order to give effect to such opinion."

129. By section 69(5) of the Ordinance, the Court of First Instance determining a question of law arising on a stated case has power, in accordance with its decision, to confirm, reduce, increase or annul the assessment determined by the Board or to remit the case to the Board with the Court's opinion thereon, whereupon "the Board shall revise the assessment as the opinion of the court may require".

130. If the matter goes on appeal, section 13(4) of the High Court Ordinance[71] confers on the Court of Appeal "all the authority and jurisdiction of the court ... from which the appeal is brought". That obviously includes the powers of the Court of First Instance under section 69(5) of the Ordinance.

131. Similarly, by section 17 of the Hong Kong Court of Final Appeal Ordinance,[72] this Court "may exercise any powers of the court from which the appeal lies ..." It follows that this Court may exercise the powers exercisable by the Court of First Instance and the Court of Appeal under section 69(5). Those powers include the power to annul the additional assessments but obviously, any fresh assessments must be raised by the Commissioner.

132. It would, in my view, be open to this Court to annul the existing additional assessments and then to remit the case to the Board with the Court's opinion thereon, expressed within the context of this judgment, directing the Board in turn to remit the case to the Commissioner with the opinion of the Court and with a direction that the Commissioner should raise fresh

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[71] Cap 4.

[72] Cap 484.

assessments on a proper basis in accordance with the Court's judgment. The assessments should plainly be annulled. But what of a remitter?

I.2 Should there be a remitter in the present case?

133. In my view, there should not be a remitter in relation to the assessments for the years 1991/92 and 1992/93. The operative scheme (whether as originally formulated or expressed as the Narrower Scheme) does not chronologically affect the taxpayer's liability to tax for those years.[73] Accordingly, section 61A is not engaged at all in relation to those years.

134. However, the additional assessments relating to the years of assessment from 1993/94 to 1995/96 require different treatment. Where section 61A(1) is engaged, section 61A(2) applies in mandatory terms: the Commissioner "shall ... assess the liability to tax of the relevant person". It follows that since section 61A(1) is engaged in relation to those three years of assessment, the Commissioner ought in principle to carry out her duty under section 61A(2) by raising fresh additional assessments on a proper basis, taking into account the opinion of this Court.

135. Such fresh assessments should be aimed at counteracting the tax benefit derived from the price-fixing arrangement for the three years in question. In practice, such assessments may be expected to be raised on the basis of an estimate of the assessable profits which would have been earned by the taxpayer if it had hypothetically paid an arm's length price for the goods delivered by DWE instead of the prices it actually paid pursuant to the price-fixing arrangement.

136. There may of course be difficulties in trying to ascertain what such arm's length prices might have been at this remove in time and one could not expect the exercise to be conducted in great detail or with a high degree of precision. In my view, however, a remitter for the sole and confined purpose of arriving at a reasonable estimate of the taxpayer's assessable profits on the aforesaid basis ought not to pose insuperable problems. The Commissioner's aim ought to be to arrive at a figure which assessable profits deriving from dealings at arm's length would at least have attained.

J. Procedural directions in section 61A cases

137. In my view, this case demonstrates a clear need in section 61A proceedings before the Board for the Revenue to identify with workable clarity at an early stage the tax benefit which it seeks to challenge, the transaction which it says had the effect of conferring that tax benefit on the taxpayer and the person or persons having the relevant dominant purpose. Such particulars should be provided as a matter of procedural fairness and to facilitate a sound analysis of the case.

138. The practice of the Board in section 61A cases should be to issue directions for such particulars to be supplied by the Revenue – which may be particulars in support of alternative

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[73] See Section E.3 above.

cases – before the start of the hearing. That is not to say that the Revenue's particulars cannot be altered. Amendment should be permitted if the evidence or submissions support the existence of a viable alternative or different scheme or tax benefit unless this causes unfairness which cannot be alleviated by case management measures (such as adjournments, the recalling of witnesses, the calling of new witnesses, etc). The aim should be that everyone knows at every stage how section 61A is sought to be applied in the particular case.

139. This procedural requirement should not place an undue burden on the Revenue since, one must assume, in deciding to invoke section 61A, it will already have identified the factual elements which, in its view, causes that provision to be engaged.

K. Orders and costs

140. I would accordingly make the following orders, namely:

(a) That the appeal be allowed;

(b) That the Court's opinion be stated, namely, that the additional assessments in respect of the years of assessment from 1991/92 to 1995/96 appealed from were not validly made in accordance with section 61A for the reasons set out in this judgment;

(c) That the aforesaid additional assessments be annulled;

(d) That the case be remitted to the Board with the aforesaid opinion of the Court and that the Board be directed to remit the case to the Commissioner with this Court's opinion and with the Board's direction that fresh additional assessments be raised on the taxpayer in respect of the years of assessment 1993/94, 1994/95 and 1995/96 in accordance with this Court's judgment; and

(e) That the parties be at liberty to make submissions in writing as to the costs of this appeal and of the proceedings below, such submissions to be lodged in Court and served on the opposing party within 21 days from the date of this judgment and that any submissions in reply be lodged and served within 21 days thereafter.

Sir Anthony Mason NPJ:

141. I agree with the judgment of Mr Justice Ribeiro PJ.

Chief Justice Li:

142. The Court unanimously allows the appeal and makes the orders set out in the concluding paragraph of the judgment of Mr Justice Ribeiro PJ.

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

(R A V Ribeiro) Permanent Judge	(Sir Anthony Mason) Non-Permanent Judge

Mr Barrie Barlow SC (instructed by Messrs Lam & Co) for the appellant

Mr Ambrose Ho SC and Ms Joyce Leung (instructed by the Department of Justice) for the respondent