HCAL 102/2016

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
CONSTITUTIONAL AND ADMINISTRATIVE LAW LIST
NO. 102 OF 2016

BETWEEN

KWP QUARRY COMPANY LIMITED	Applicant
and	
INLAND REVENUE BOARD OF REVIEW	Respondent
THE COMMISSIONER OF INLAND REVENUE	Interested Party

Before: Hon Anthony Chan J in Court
Date of Hearing: 12 September 2017
Date of Judgment: 10 October 2017

J U D G M E N T

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1. This is the judicial review application of KWP Quarry Co Ltd (Taxpayer) in respect of the decision of the Inland Revenue Board of Review (Board) dated 8 April 2016 (Decision) made in Case No B/R 10/11 refusing to state a case on a question of law for the opinion of the Court of First Instance upon the Taxpayer's application, which was made pursuant to the then prevailing provisions of s.69 of the Inland Revenue Ordinance, Cap 112 (Ordinance).

Background

2. The Taxpayer had a contract with the Hong Kong Government (Contract) to carry out civil engineering works for the rehabilitation of the Anderson Road Quarry (Quarry). Essentially, the rehabilitation work was to convert the Quarry into a prescribed landform which would be geotechnically stable. The Contract also entitled the Taxpayer to operate the Quarry. The Taxpayer was to pay HK$218 million to the Government over the life of the Quarry.

3. In order to bring the Quarry into a condition ready for excavation (of rock), it was necessary to remove the "overburden" on top of the rock. Overburden is a term used in quarrying to mean weathered rock and soil of low value. In removing

the overburden, costs were incurred by the Taxpayer. Pursuant to the Contract, the overburden had to be removed by the Taxpayer and back-filled into the Drop Cut area.

4. The Taxpayer said that the costs of removing overburden (Costs) which were incurred in relation to its activities at the Quarry were deductible in the calculation of its assessable profits for the years of assessment from 2002/03 to 2007/08. The Commissioner of Inland Revenue (CIR) disagreed, and the matter went on appeal to the Board for determination (Appeal).

5. By a decision dated 31 December 2015 (Appeal Decision), the Board dismissed the Taxpayer's appeal against the profits tax assessments for the years identified above. Hence, the Taxpayer's subsequent case stated application.

6. There were 2 plans annexed to the Appeal Decision, Annexures II and III, from which one can see the enormous size of the Quarry and where the overburden was located.

7. As pointed out by Ms Cheng SC, who appeared for the CIR, for a proper understanding of this case it is important to note the distinction between a quarry and a mining operation, especially the requirement for overburden removal. A mine can be defined as the extraction site of metal or solid fossil fuel, and a mine can be underground or above ground. There are 3 main types of mines, namely, underground mines, open pit mines and strip mines. The evidence before the Board from a geological consultant called by the Taxpayer as recorded in the Appeal Decision was that :

> "13.4. In each of the underground, open pit/open cut/opencast and strip mining, it is necessary for the operator to win access to the ore body (minerals). The operator has to remove the overburden and make a first cut' through the layers of rock and other weathered materials to get at the target minerals. That is to say the operator must cut through rock and weathered materials to access the minerals.
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> 13.5. Once the minerals in an open/pit cut/opencast mine have been reached, the mining operation consists of subsequent cuts into overburden (in mining terms) to access the minerals. Waste material is dumped in the void created by the previous cut. The process of subsequent cuts to access the minerals occurs over and over again in operation of the mine, for the life of mine.
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> 13.6. A quarry is commonly defined as an excavation or system of excavations made for the purpose of, or in connection with, the extraction of rock ... A quarry is above ground. As with open pit ... and strip mining, the operator has to make a 'first

> cut' but it is shallower and narrower than in open pit ... and strip mining."

8. The issue in the Appeal was whether the Costs were capital or revenue in nature. The Board held that such costs belonged to the former.

9. The findings of the Board can be found in paras 49 to 53 of the Appeal Decision. It is necessary to set them out in this judgment :

"NATURE OF THE COSTS

49. The Appellant argued that the Costs were of a recurring nature, since they had to be incurred in each of the years of assessment in question.

50. The Board agrees with the Respondent's submission that while the Costs were incurred in each of the years of assessment in question, that was *not* because the Appellant had to go back and remove overburden in areas where it had already been removed; *nor* was it because overburden was sandwiched within the rock so that it had to be continuously removed as rock was extracted. Rather, we find the Costs were incurred over a long period of time because:

50.1. the Quarry spanned a very large area and so it took a considerable length of time (a few years) to remove all the overburden;

50.2. as a matter of practicality, the overburden was removed bit by bit as rock extraction progressed across the Quarry, rather than all in one go, because it was necessary to accommodate the overburden once it was removed and it could not simply be dumped into the drop cut — due to the Appellant's rehabilitation obligations under the Rehabilitation Contract, the backfilling had to be engineered to ensure that the resulting piece of land would be stable and safe;

51. The Board also agrees with what the Respondent submitted in para 26 of the Respondent's closing submissions :

'The point is that once overburden had been removed in any particular spot in the Quarry, the process of overburden removal was completed for that particular spot, and no further Costs had to be incurred in respect of that spot. The fact that overburden had to be removed in many parts of the Quarry is very different from having to remove overburden repeatedly

in the same part of the Quarry. To take an analogy: for example, a large factory which manufactures garments may require the installation of hundreds of sewing machines, but the fact that the installation process has to be carried out hundreds of times does not thereby render that installation cost a "recurring" one — once each machine is installed, it is ready to be used to generate profit, and it does not need to be installed again. A recurring cost would be, for example, the cost of oiling each machine from time to time — it is a process which is repeated over and over with the same machine in the course of the profit-making process. The former is a "once and for all" expense, whilst the latter is a recurring expense.'

52. From the evidence of Mr Fowler we find as follows:

52.1. On the picture on page 18 in PF-6 referred to in his statement, and exhibited as Annexure IV hereto, which is a side view of the Quarry, the overburden was not the green layer but the thin layer, between the vegetation layer and the layer of solid rock;

52.2. Conceptually, in Annexure III,

(a) the area marked by the First Line and the Second Line was the area of the Overburden which the Appellant had to remove from the site;

(b) the area marked by the Second Line until it joined the First Line and thereafter the First line on the one hand and the Third Line on the other hand to the left of the intersection was the area of the Quarry;

(c) the area marked by the Third Line and the First line to the right of the intersection was the area of the Drop Cut A1 area which had been evacuated before the commencement of the contract in question and which the Respondent had to fill back in accordance with the contract with the Government;

52.3. The Respondent had to remove the overburden progressively (as if one were removing rings of an onion). The Overburden was removed from a section of around 50 metres by 50 metres in area, and the rock

underneath that section was quarried. After the quarrying was complete, the process would be repeated on an adjacent section of the Quarry until they reached the various levels of plateau terraces as shown by the Third Line in order to maintain a safe working environment and achieve the final landform as required by the Rehabilitation Contract.

52.4. We do not agree with Mr Fowler's views in his witness statement at paragraphs 34 and 35. We are satisfied that the first-cut and the work described in paragraph 52.3 herein are of a capital nature and as characterised by the Respondent in paragraph 51 herein. They are part of the infrastructural works necessary to give lasting benefit to the Appellant's other continuous operations.

53. We are satisfied that the Costs are of Capital nature."

10. The question proposed by the Taxpayer in its application to the Board for a case stated (Proposed Question) was as follows :

"Did the Board of Review err in law in concluding, upon the facts found by them, that, for the purposes of Part IV of the Ordinance, within the assessment of the Taxpayer's assessable profits, the Taxpayer's expenditure on Overburden Costs, during each of the years of assessment 2002/03 to 2007/08, was not deductible revenue expenditure because the Overburden Costs were capital in nature?"

Issues

11. It is common ground that there are 4 issues before this court, namely :

(1) Whether there is an arguable case on a proper question of law in respect of the question whether the Costs were capital or revenue in nature;

(2) The threshold of arguability in respect of issue (1);

(3) Whether a proper question of law has to identify the error(s) of law the Board had allegedly made;

(4) The requirements over the contents of a stated case.

12. These issues are intertwined. In respect of issues (3) and (4), the CIR's position is that they were not the subject matters of complaint in the From 86 before the court. However, the determination of those issues would go to fortifying the Decision. Logically, the issues should be determined in the order of (3), (2), (1) and (4). The last issue is not critical for the purpose of this judgment.

Law

13. Ms Cheng had helpfully identified a number of relevant principles of law in her written submissions at paras 23 to 24. They may be summarised as follows :

(1) The right of appeal under s.69 of the Ordinance is not unqualified and absolute. Any proposed question of law must be proper. See *Honorcan Ltd v IRBR* [2010] 5 HKLRD 378, §§49 and 50.

(2) To exercise the right of appeal under s.69, a taxpayer's proposed question of law must satisfy a "qualitative" aspect if it is to form part of a case stated. See *D43/09* (2010) 24 IRBRD 827, §17.

(3) The Board has a power to scrutinise any question of law proposed before it for a case stated to ensure that it is one which is proper for the court to consider. If the Board is of the view that the point of law is not proper, it should decline to state a case. See *Honorcan*, §50.

(4) A question may superficially appear to be a question of law, but if it is general and vague and does not identify the issue to be argued, it is not satisfactory. In *CIR v IRBR* (*Aspiration*) [1989] 2 HKLR 40, Barnett J held as follows:

At 50G, "I am not prepared to accept that an applicant for a case stated may rely on a question of law which is imprecise or ambiguous and which gives the Board no clear idea of what material must be marshalled in their case";

At 50J, "Unless the Commissioner can identify findings of fact for which there is no evidence or inferences which are wholly unsupportable and thus wrong in law, I do not regard the second question as a question of law";

At 56E, "I fail to understand why the Commissioner cannot or will not identify the individual matters he wishes to challenge"; and

At 58B, "The first and third questions are superficially questions of law but vague in the extreme and unsatisfactory. It was proper in the circumstances for the Board to query them."

(5) A proper question of law not only has to be a question of law, but also needs to be arguable and not an abuse of process if it were to be submitted to the court for determination: *Honorcan*, §§46 to 53.

(6) The responsibility for preparing a case stated lies on the party requiring the case to be stated: *Lee Yee Shing v CIR* (2008) 11 HKCFAR 6, §52.

(7) In *Chinachem Investment Co Ltd v CIR* 2 HKTC 261 at 303, Huggins VP observed that: "… the established practice in Hong Kong is that where parties are professionally represented they shall draft the Case Stated and submit it to the tribunal. The reason is obvious: the parties know better than anyone else what points they wish to take on the appeal, what findings of fact they wish to contend are relevant to those points and what arguments they advanced."

(8) The Board has the final responsibility for the case stated. See *Lee Yee Shing*, §52: "It is, of course, for the tribunal to determine whether it will accept or amend or reject the applicant's draft."

Whether the Proposed Question is a proper question of law

14. I am inclined to agree with Mr Wong SC, who appeared with Mr Lui for the Taxpayer, that it is not altogether clear whether the Board had accepted the CIR's objection that the Proposed Question failed to identify the error of law contended. However, it is clear that the Board was aware of its duty to scrutinise the Proposed Question and was certainly not happy with it :

(1) Para 4 of the Decision referred to the CIR's submission that it was necessary for the Taxpayer to identify the error of law on which its challenge of the Appeal Decision was made;

(2) Para 5 quoted the Taxpayer's reply to the CIR's submission, in which it was maintained that the Proposed Question was proper. In the alternative, the Board was invited to state a case based on "questions of law outlined on page 2 of this letter". On that page, allegations were made in respect of misunderstanding by the Board of some of the authorities; misapplications of the requirements of ss.14-17 of the

Ordinance to the facts found; and failure to come to certain conclusions on the evidence;

(3) Para 7 referred to the Taxpayer's primary stance: "it is not prepared to state these matters in any precision in its draft case but will leave these to submissions at the hearing [of the case stated]". It is tolerably clear that this was referring to, or at least included, the Taxpayer's refusal to elaborate on the Proposal Question;

(4) Para 9 stated: "Thus, the only remaining issue is with the question of whether the errors of law have been stated with sufficient clarity as required for this case stated application.";

(5) The Board referred to the relevant principles in paras 12 to 16 under the heading "The Requirement of a Stated Case". In particular, *Chinacham*, *Aspiration* and *Honorcan* (see above). The Board also quoted a remark of Reyes J made in *Same Fast Ltd v IRBR* (2007-08) IRBRD, vol 22, 321, §9: "… I find the questions to be embarrassing as a whole. Simply on account of their wordiness and opacity, Same Fast's questions do not appear to me at all appropriate for a case stated."

(6) Para 21 referred to the function of the Board to vet the draft case stated to see that there is no abuse of the process.

15. In my view, even if the Board did not rely on the inadequacy of the Proposal Question as an independent or additional ground for refusing the case stated application, the absence of a proper question of law before the Board must, at least, be a matter which goes to the discretion of this court whether to grant relief in this application.

16. The arguments under this head are within a narrow compass. To begin, although the Taxpayer had cited to the court a number of cases where the question of law in the case stated was similar in form to the Proposed Question, Mr Wong accepted that the issue is one of substance and not form.

17. Ms Cheng submitted that whether a general question in the form of the Proposed Question is a proper question of law depends on the circumstances of the case: see *Nam Tai Trading Co Ltd v BOR* (2009) 8 HKTC 258, §18. I agree.

18. In *Nam Tai*, the question of law was similar in form to the Proposed Question. After holding that such a question raised a question of law, and depending on the circumstances, it might be a proper question. Tang VP (as he then was) continued: "Here, however, the Board has found as a matter of fact that the expenses and deductions were not incurred or expended in or for the purpose of the making of

profits. It is difficult to understand how [that question] could be a proper question in the context of this case."

19. The same may be said in respect of the Proposed Question. In the Appeal Decision, the Board found against the Taxpayer in that the Costs were not revenue expenditure, it is difficult to see how a general challenge that the Board had erred in law can constitute a proper question of law. The Proposal Question is singularly uninformative as to the basis of the alleged error. It is indeed quite embarrassing for the Board to deal with such a question, and impossible for it to properly discharge its function to scrutinise the same.

20. Mr Wong sought to defend the Proposed Question by arguing that it identified the question of law which the Board had wrongly decided, and that the Board, having heard the arguments of the parties in these matters, should have no difficulty scrutinising it. With respect, such submissions do not address the lack of identification of the Taxpayer's complaint. The Board should not be put in a situation to guess which of the arguments previously advanced by the Taxpayer should have been accepted or whether all of its arguments should have been accepted. If the Taxpayer refused to fulfil its obligations under s.69, it had no right to have a case stated.

21. In the course of the Taxpayer's submissions, and with some pressure from the court, Mr Wong informed the court that the Taxpayer's complaint is one of error of law on the face of the Appeal Decision, namely, the Board had failed to answer correctly the legal question whether the Costs were capital or revenue in nature in that based on para 52.3 of the Appeal Decision, such Costs belonged to the former[1] (Reformulated Question). If that was the challenge, it could have been formulated as the proposal question of the case stated. This serves to illustrate the lack of merits in the Taxpayer's arguments on this issue.

22. Later in the proceedings, Mr Wong submitted that the Taxpayer is not bound by the Reformulated Question for the purpose of the hearing of the case stated (assuming that the Taxpayer succeeded in this application). With respect, such a stance is difficult to understand and unhelpful to the Taxpayer's cause.

23. The mandamus being sought in this application is premised on the Proposed Question, which I have found not to be a proper question. If this application is to stand any chance of success, there will have to be a proper question of law before this court. Assuming that the Reformulated Question meets the requirement, and the case stated proceeded on that basis (there was actually no application by the Taxpayer to substitute the Proposed Question with the Reformulated Question), it is difficult to see how it can be right for the Taxpayer to later change its case.

[1] Mr Wong's formulation has been polished in this judgment.

24. Although it may ultimately be a question to be determined by the court hearing the case stated, the stance taken by the Taxpayer exposes, firstly, the lack of conviction, and perhaps merits, in the Reformulated Question.

25. Secondly, it vindicates the grievance of the Board, and the CIR, on the opacity of the Taxpayer's challenge (see para 14 above). It is apt to refer to the observation made by Barnett J in *Aspiration* at 58F about the true intention of the applicant in that case: "What he wants is permission to go beating about the evidential undergrowth in the hope of flushing out some useful pieces of evidence that support his view …". Such observation applies by analogy to the position before this court.

26. Thirdly, the Taxpayer's approach to litigation is quite contrary to the Civil Justice Reform.

27. For these reasons, and on the lack of any proper question of law alone, I would decline to grant any relief to the Taxpayer.

28. The determination of this issue has rendered it unnecessary to decide the remainder of the issues. However, out of deference to the submissions of senior counsel and for completeness, I shall deal with them, but only in relation to the Reformulated Question given that the Proposed Question is fundamental defective.

Threshold of arguability

29. There are 2 limbs to this issue. Firstly, the general threshold of arguability for the purpose of a case stated. Secondly, the threshold in this case has to reflect the standard which the Taxpayer has to satisfy the court hearing the case stated that the Board had erred.

30. On the first limb, the issue was considered in *Honorcan* by Fok J (as he then was) in a detailed treatment on the nature of an applicant's right to appeal on a point of law under s.69. It is reasonably clear from the judgment, at §§38 to 53, that the court took the view that the threshold was whether the point of law was "plainly and obviously unarguable" (§50).

31. Despite Ms Cheng's valiant attempt to persuade the court, I see no good reason to depart from the view taken in *Honorcan*.

32. On the second limb, Ms Cheng submitted that the Reformulated Question[2] is in truth a challenge based on the proposition that the Board was perverse or irrational in concluding that the Costs were capital in nature, and that the true and only reasonable conclusion is that they were revenue in nature. Hence, the threshold which the Taxpayer has to satisfy is that such proposition, which assumes a high burden, is not plainly and obviously unarguable.

[2] And the Proposed Question.

33. Based on *Kwong Mile Services Ltd v CIR* (2004) 7 HKCFAR 275, §§31 to 37, it appears to me that in the context of s.69 there are 3 types of error of law, namely:

(1) An error of law which is specifically identifiable and apparent on the face of the record (Kwong *Mile*, p.287G);

(2) Where the true and only reasonable conclusion contradicts the determination appealed against, in which case the appellate court will assume that the determination resulted from an error of law (p.287I); and

(3) Where the determination is perverse or irrational; or there was no evidence to support it; or it was made by reference to irrelevant factors or without regard to relevant factors. It is not necessary to identify a specific error of law; if the determination cannot be supported the court will infer that the decision-maker misunderstood or overlooked relevant evidence or misdirected itself in law (p.288A-B).

34. There is overlap between types (2) and (3) (p.288E-F), and some of the formulations found in the authorities are alternative ways of saying the same thing (p.288E).

35. Ms Cheng had placed emphasis on para 37 of *Kwong Mile* :

> "In an appeal on law only the appellate court must bear in mind what scope the circumstances provide for reasonable minds to differ as to the conclusion to be drawn from the primary facts found. If the fact-finding tribunal's conclusion is a reasonable one, the appellate court cannot disturb that conclusion even if its own preference is for a contrary conclusion. But if the appellate court regards the contrary conclusion as the true and only reasonable one, the appellate court is duty-bound to substitute the contrary conclusion for the one reached by the fact-finding tribunal. The correct approach for the appellate court is composed essentially of the foregoing three propositions. These propositions complement each other， although the understandable tendency is for those attacking the fact-finding tribunal's conclusion to stress the third one while those defending that conclusion stress the first two."

36. However, Mr Wong submitted that the Reformulated Question belongs to the first type of error of law[3]. Although I can see some force in Ms Cheng's submission (see para 32 above), there is no good reason not to consider the

[3] Possibly to overcome the higher burden which the Taxpayer may otherwise have to satisfy (see paras 32 to 35 above).

Taxpayer's case in the way in which it was advanced. In the premises, the arguability threshold is whether the Reformulated Question is plainly and obviously unarguable.

Arguability

37. I bear in mind the low threshold, but I am unable to agree that the Reformulated Question is arguable.

38. The Taxpayer's argument is boiled down to the contention that the process or methodology by which it removed the overburden, namely, removing the overburden in an area of 50m x 50m, followed by quarrying of that area, and then repeating the exercise with the next 50m x 50m area, rendered the Costs revenue by nature[4]. The reason is that the Costs were incurred in the actual process of quarrying, ie, revenue generating, rather than incurred in acquiring or constructing any infrastructure or with any lasting benefit. Mr Wong drew a parallel between the removal of overburden under this process with that of the dyeing of cloth as part of the manufacturing of garment.

39. Firstly, there is no support from any of the authorities cited in para 67 of the Form 86, nor those by Ms Cheng in the CIR's written submissions, for the proposition that the methodology adopted in generating revenue would determine the nature of the expenses. Rather, the authorities provide various guidance to assist a tribunal to answer the question (see para 67.7 of Form 86).

40. There is no dispute that the costs of getting the Quarry into a condition fit for quarrying were capital costs. It is important to bear in mind the finding of fact that this was not a case where there was overburden sandwiched between the rock and the Taxpayer was required to remove it continuously as part of the rock extraction (Appeal Decision, §50). Hence, if all the overburden were removed in one go to get the Quarry into a condition ready for quarrying, it is not open to the Taxpayer to argue that the Costs were revenue expenditure.

41. I am unable to see why the fact that the overburden was removed by stages due to practicality considerations (Appeal Decision, §50) would change the nature of the Costs. This is the effect of the Taxpayer's contention that there is an error of law on the face of the record in light of para 52.3 of the Appeal Decision. Put another way, the features identified in para 52.3 should lead to the conclusion that the Costs were revenue expenditure. I find no support in the authorities for any such proposition.

42. Secondly, it is wrong for the Taxpayer to isolate part of the relevant facts found by the Board (para 52.3 of the Appeal Decision) and contend that it had erred when the Appeal Decision was based on all the relevant facts.

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[4] The court was referred to the arguments in para 67 of the Form 86 in particular.

43. Thirdly, the parallel drawn by Mr Wong with the dyeing of cloth is inappropriate. If a parallel is to be drawn in this case, an appropriate one is where a car builder has decided to acquire his tools and machinery in stages because, eg, he can spread the expenditure over a period of time. Therefore, the body panel press was only acquired after the chassis was built and ready to receive the panels. Such a process cannot change the nature of the costs of acquiring the press, which plainly are capital costs.

The contents of a case stated

44. As indicated above, this is not a critical issue. The arguments here spring from the suggestion by the Taxpayer's solicitors in a letter that the Board had made certain factual findings, with which the Board disagreed (Decision, §23). However, Mr Wong submitted that it was a matter of poor drafting by the author of the letter, and he disavowed any attempt to challenge the finding of facts by the Board.

45. The law is quite clear that the burden of drafting a case stated rests with the applicant (if he is represented). Plainly, the drafting will have to satisfy the requirements of the Board who bears the ultimate responsibility over the case stated. If the Board is not satisfied with the draft, it can be sent back for amendment. Any failure to amend the draft as required will cause delay to the process, and that will serve to encourage the applicant to fulfil his responsibility.

46. In light of Mr Wong's submission, I do not believe that there is any live issue under this heading.

Conclusions

47. For the reasons stated above, this application is dismissed with costs to the CIR, to be taxed if not agreed.

48. I am grateful to counsel for their assistance.

(Anthony Chan)
Judge of the Court of First Instance
High Court

Mr Stewart K M Wong SC and Mr Mike Lui, instructed by Woo Kwan Lee & Lo, for the Applicant

Ms Yvonne Cheng SC, instructed by Department of Justice, for the Interested Party