HCIA 2/2017
[2018] HKCFI 373

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
INLAND REVENUE APPEAL NO 2 OF 2017

BETWEEN

CHINA MOBILE HONG KONG COMPANY LIMITED Appellant

and

COMMISSIONER OF INLAND REVENUE Respondent

Before: Hon Chow J in Chambers (Open to Public)
Date of Hearing: 1 November 2017
Date of Decision: 27 February 2018

D E C I S I O N

Introduction

1. The principal issue for determination is whether it is reasonably arguable that certain upfront lump sum spectrum utilisation fees ("Upfront SUFs") paid by China Mobile Hong Kong Company Limited ("Taxpayer") to the Telecommunications Authority ("TA") are "revenue", as opposed to "capital", in nature.

2. A subsidiary issue for determination is whether an appellant is required to formulate a proper question, or proper questions, of law in the statement required by Section 69(3)(a)(ii) of the *Inland Revenue Ordinance*, Cap 112 ("the Ordinance") when seeking leave to appeal, and whether the Taxpayer has done so in the present case.

Basic Facts

3. The background facts of this matter are set out in a written decision ("the Decision") of the Board of Review ("the Board") dated 17 January 2017. The following brief summary should suffice for the present purpose.

4. The Taxpayer is a mobile telecommunications and related services provider. Over the years, it has been granted various licences to operate mobile telecommunications services in Hong Kong. It uses certain frequency bands on the radio spectrum in its day-to-day provision of services to its customers, from which it derives income which is assessable to profits tax in Hong Kong.

5. In December 2007, the TA proposed to allocate some frequency bands for the provision of broadband wireless access services. An auction ("the 4G Auction") of radio spectrum for the provision of 4G broadband wireless access services would be held, and the use of, or the right to use, the frequency bands would be subject to the payment of an one-off Upfront SUF, the amount of which was to be determined by the highest valid bid for the frequency bands in the auction.

6. In 2008, the TA further proposed to make available certain frequency bands to incumbent 2G licensees, of which the Taxpayer was one. An auction ("the 2G Auction") would be conducted for the assignment of additional 2G frequency bands to the incumbent 2G licensees, and the use of, or the right to use, the frequency bands would be subject to the payment of SUFs consisting of (i) annual payments determined by reference to network turnover or the bandwidth assigned (whichever is higher), and (ii) an upfront payment determined by the highest valid bid for the relevant frequency bands in the auction.

7. The 4G Auction was completed on 22 January 2009. The Taxpayer was the successful bidder of one of the frequency bands. The Upfront SUF payable by the Taxpayer was in the lump sum of HK$494,700,000.

8. The Taxpayer was also the successful bidder of two of the frequency bands at the 2G Auction, which was completed on 10 June 2009. The Upfront SUFs payable by the Taxpayer were in the total sum of HK$15,120,000.

9. The aforesaid Upfront SUFs were paid, or treated as paid (by set-off), in 2009. In its audited financial statements for the years ended 31 December 2009 to 2011, the Taxpayer classified the Upfront SUFs as Non-Current Intangible Assets and amortised them on a straight-line basis over the relevant licence periods.

10. The Assessor opined that the Upfront SUFs were capital expenditures, and disallowed the deduction of amortization charges on the Upfront SUFs. Accordingly, he raised on the Taxpayer additional profits tax assessments for the years of assessment 2009/10 to 2011/12 ("the Assessments"). The Assessments were confirmed by the Deputy Commissioner of Inland Revenue on 30 December 2014.

11. The Taxpayer's appeal against the decision of the Deputy Commissioner was dismissed by the Board, which held that the Upfront SUFs were capital in nature. The Board took the view, *inter alia*, that:-

(1) the subject matter of each of the 4G Auction and the 2G Auction was the granting of the relevant unified carrier licence ("UCL"), together with the right to use the specified frequency bands; and

(2) by paying the Upfront SUFs, the Taxpayer acquired the exclusive right to use the assigned spectrum for a period of about 12 years under the amended 2G UCL and 15 years under the 4G UCL without the interference of other mobile telecommunications operators in the market (see paragraph 58 of the Board's Decision).

12. On 15 February 2017, the Taxpayer issued a summons ("the Summons") under Section 69(3)(a)(ii) of the Ordinance seeking leave to appeal against the Board's Decision. In the Summons, the following single question of law, described by Mr Stewart Wong, SC (for the Taxpayer) as the overarching question, is identified:-

> "Whether the spectrum utilization fees paid by the Appellant to the Telecommunications Authority, the annual amortised amounts of which were disallowed as deductions in the additional profit tax assessments 2009/10, 2010/11 and 2011/12 raised on the Taxpayer, are revenue or capital in nature."

13. Attached to the Summons is a "Statement of the Appellant ('Taxpayer') of the Grounds of Appeal and Reasons Why Leave Should Be Granted" ("the Statement") pursuant to Section 69(3)(a)(ii) of the Ordinance. In paragraphs 8 to 16 of Section B of the Statement, 8 proposed grounds of appeal against the Decision, with detailed arguments in support of each ground, are set out.

14. The Commissioner opposes the application for leave to appeal, on 3 broad grounds:-

(1) The proposed question of law put forward by the Taxpayer is not a proper question of law for the purpose of Section 69 of the Ordinance.

(2) In any event, none of the 8 proposed grounds of appeal gives rise to any arguable question of law.

(3) In addition, the Taxpayer has no proper basis to suggest that there is some other reason in the interests of justice why the proposed appeal should be heard.

Whether any arguable question(s) of law raised in the proposed appeal

15. Under Section 69(3)(e) of the Ordinance, the Court of First Instance shall not grant leave to appeal unless it is satisfied:-

(1) that a question of law is involved in the proposed appeal; and

(2) that –

(a) the proposed appeal has a reasonable prospect of success; or

(b) there is some other reason in the interests of justice why the proposed appeal should be heard.

16. For this purpose, a proposed appeal has a reasonable prospect of success if it is "reasonably arguable"; it is not necessary to show that the proposed appeal will "probably" succeed.

17. The principal point raised by Mr Wong on behalf of the Taxpayer in the proposed appeal is that the Board erred in finding that the Upfront SUFs are capital in nature in that they were paid for the right to use radio spectrum, and not for the use of such spectrum. In this regard, Mr Wong places strong reliance on various provisions of the *Telecommunications Ordinance*, Cap 106 ("the TO"), including Section 32I(1), said to be the statutory basis for charging SUFs, which states as follows –

> "Subject to the consultation requirement under section 32G(2), the Authority may by order designate the frequency bands in which the use of spectrum is subject to the payment of spectrum utilization fee by the users of the spectrum." [emphasis added]

18. In support of the proposition that the Upfront SUFs were paid for the use of the radio spectrum, Mr Wong also relies on, *inter alia*, (i) various regulations made under the TO, (ii) the circumstances in which SUFs were changed from annual royalty payments to upfront lump sum payments, (iii) the fact that the Commissioner previously accepted that annual payments of SUF were revenue in nature and deductible, and (iv) the circulating capital test, which the Board considered did not assist the Taxpayer.

19. Mr Wong further argues that had the Board correctly held that the Upfront SUFs were for the use of the radio spectrum, such payments would (or should) have been held to be revenue in nature and therefore deductible as outgoings or expenses for the purpose of ascertaining the Taxpayer's chargeable profits under Section 16(1) of the Ordinance. Mr Wong refers to the speech of Lord Morris of Borth-y-Gest in *Regent Oil Co Ltd v Strick (Inspector of Taxes)* [1966] AC 295 at 334, where it was said that "[t]here may well be a difference between a case where a lump sum payment is made to acquire the right to occupy premises for a period say of 21 years and a case where by contract a right is acquired to occupy premises for 21 years with an obligation to make periodic payments for such right to occupy", as supporting a distinction between (i) a payment made for the right to use an asset, and (ii) a payment made for the use of an asset.

20. On behalf of the Commissioner, Mr Eugene Fung, SC, argues that the issue as to whether the Upfront SUFs are capital or revenue in nature does not turn on the proper interpretation of Section 32I of the TO, or whether the payments were for the right to use, as opposed to the use of, the radio spectrum. Rather it is a matter to be approached by applying common sense to the particular facts and circumstances of the case, which the Board has done. Mr Fung further says that the Board has properly and correctly held, as a matter of fact, that the Upfront SUFs were paid for the assignment of, or the right to use, the specified radio spectrum and the grant/amendment of the UCLs for the Taxpayer to operate its telecommunications business. A challenge to a finding of fact by the Board cannot be disguised as one based on statutory construction, as the Taxpayer has sought to do.

21. There are other subsidiary arguments raised by Mr Wong and Mr Fung which I do not propose to set out or analyse them here. As earlier mentioned, the test for determining whether leave to appeal should be granted under Section 69(3)(e) of the Ordinance is whether the proposed appeal is "reasonably arguable". It is not a high threshold. I consider that the proposed appeal is reasonably arguable, and leave to appeal ought to be granted. Having reached this conclusion, it would not be appropriate for me to dwell further on the merits of the proposed appeal.

The requirements of Section 69(3) of the Ordinance

22. Under the old Section 69 of the Ordinance, a party dissatisfied with a decision of the Board could make an application requiring the Board to state a case on a question of law for the opinion of the Court of First Instance. Under the case stated procedure, a question of law must be identified and stated in the case. Further, it was established that the Board was entitled to subject a question of law that it was asked to state to a vetting procedure by way of qualitative assessment. Such assessment was explained by Fok J (as he then was) in *Honorcan Ltd v Inland Revenue Board of Review* [2010] 5 HKLRD 378, at paragraph 50:-

> "… I do not consider that section 69(1) does confer an absolute and unqualified right of appeal. In my judgment, the Board is duty bound to decline to state a case if the question of law proposed to be stated is not a proper one, as the authorities have consistently held. A question proposed to be stated may, it seems to me, be improper for various reasons, as illustrated in the cases discussed above: it may be irrelevant or premature; it may be academic to the outcome of the appeal; it may be embarrassing; it may be plainly and obviously unarguable."

23. The current Section 69 of the Ordinance (introduced by Section 8 of Ordinance 17 of 2015), so far as relevant, provides as follows:

> "(1) Where the Board of Review has made a decision on an appeal under section 68, the appellant or the Commissioner may appeal to the Court of First Instance against the Board's decision on a ground involving only a question of law.

(2) No appeal may be made under subsection (1) unless leave to appeal has been granted …

(3) For the purposes of an application to the Court of First Instance under subsection (2)(a) for leave to appeal –

(a) the application –

(ii) must be made by a summons supported by a statement setting out –

(A) the grounds of the appeal; and

(B) the reasons why leave should be granted;

(c) the Court of First Instance may –

(i) determine the application without a hearing on the basis of written submissions only; or

(ii) direct that the application be considered at a hearing...;

(e) leave to appeal must not be granted unless the Court of First Instance is satisfied –

(i) that a question of law is involved in the proposed appeal; and

(ii) that –

(A) the proposed appeal has a reasonable prospect of success; or

(B) there is some other reason in the interests of justice why the proposed appeal should be heard".

24. Also relevant for the present purpose is paragraph 2(2) of Practice Direction 34 (Application for Leave to Appeal Against Board of Reivew's Decision):-

"The statement required under section 69(3)(a)(ii) … must –

(2) in setting out the grounds of appeal, identify and state precisely the question of law involved in each ground".

25. On the face of paragraph 2(2) of Practice Direction 34, it would seem to be clear that the statement required by Section 69(3)(a)(ii) must set out the grounds of appeal, and identify and state precisely the question of law involved in each ground.

26. Mr Wong argues, however, that under the new appeal regime, it is not strictly necessary to formulate a precise question of law in the statement required by Section 69(3)(a)(ii), because that sub-section only requires the statement to set out (*inter alia*) the "grounds of appeal". Mr Wong says that the proper focus of inquiry should now be whether a question of law is "involved" in the proposed appeal. He argues that a Practice Direction does not have the force of law, and any inconsistency between the requirements of Section 69(3)(a)(ii) and Practice Direction 34 should be resolved in favour of the former.

27. In my view, notwithstanding the change of the appeal regime under Section 69 from a case stated procedure to an ordinary appeal procedure (brought with the leave of the court), the basic requirement that the appellant must identify and state a proper question of law for determination by the court remains. This requirement is implicit in the various provisions in the current Section 69 and serves the purpose of assisting the court in dealing with applications under that section, in particular:-

(1) whether the proposed appeal involves a proper question of law that ought to be heard;

(2) whether the application for leave should be determined without a hearing; and

(3) whether the proposed appeal has a reasonable prospect of success.

28. Viewed in this light, paragraph 2(2) of Practice Direction 34 is entirely consistent with the current Section 69 of the Ordinance. It is, I consider, well within the powers of the Chief Justice to issue Practice Direction 34, including paragraph 2(2) thereof, to give effect to, or in furtherance of the objectives of, Section 69(3)(a)(ii).

29. In this regard, I note that in *CIR v Right Margin Ltd*, HCIA 4/2016 (12 October 2017), at paragraphs 9, 12 and 13, G Lam J referred to paragraph 2(2) of Practice Direction 34 and plainly considered that under the new appeal regime, the appellant was required to identify and state a proper question of law involved in the proposed appeal as would be required under the old case stated procedure. At paragraphs 12-13, the learned Judge stated as follows:-

> "12 … The question of law said to be involved in this ground is specified to be: was the Board wrong in law in coming to the conclusion that the taxpayer had discharged its burden of proof for demonstrating to the Board that the provision for the interest of HK$156,615,001 was a doubtful debt estimated to the

satisfaction of the assessor to have become bad during the basis period?

13. I have to say this is not a proper ground of appeal or question of law. It merely turns the conclusion of the Board into the form of a question adding a question mark at the end. In *Commissioner of Inland Revenue v Inland Revenue Board of Review* [1989] 2 HKLR 40 at 50G and 58B (commonly known as the '*Aspiration case*'), Barnett J stated that imprecise, vague or ambiguous questions are not acceptable. While that was said in the context of the former procedure of appeal by way of case stated, I see no reason why the standard required of the questions of law advanced under the new s 69 should be any lower."

30. As to what would constitute a proper question of law for the purpose of Section 69, I am content to adopt the following principles as formulated by Mr Fung:-

(1) The right of appeal under Section 69 is not unqualified and absolute. Any proposed question of law must be proper and satisfy a "qualitative" aspect (see *Honorcan Ltd v Inland Revenue Board of Review*, *ante*, at paragraphs 49-50; *KWP Quarry Co Ltd v IRBR*, HCAL 102/2016 (10 October 2017), at paragraphs 13(1)-(2), *per* A Chan J).

(2) A question of law may superficially appear to be a question of law, but if it is general and vague and does not identify the issues to be argued, it is inadequate (see *CIR v IRBR (Aspiration)* [1989] 2 HKLR 40, at 50G-J, 56E and 58E *per* Barnett J; *KWP Quarry Co Ltd*, *ante*, at paragraph 13(4)).

(3) It is not a proper question of law by turning the ultimate conclusion of the Board into a form of question (see *Right Margin Ltd*, *ante*, at paragraphs 12-13).

(4) It is also not a proper question of law if the framed question fails to identify precisely the point of law involved or any specific legal error or question (see *Right Margin Ltd*, *ante*, at paragraphs 32, 33 and 36).

(5) Whether or not a proposed question is a proper question of law depends on the circumstances of the case (see *KWP Quarry Co Ltd*, *ante*, at paragraphs 17-18).

31. I consider that the Taxpayer has, in the present case, failed to sufficiently comply with the requirements of Section 69(3)(a)(ii) of the Ordinance and paragraph 2(2) of Practice Direction 34, in that:-

(1) The single question of law identified in the Summons is not a proper question of law, because it merely turns the ultimate conclusion of the Board into a form of question.

(2) The Statement, while it sets out the grounds of appeal, fails to identify and state precisely the question of law involved in each ground.

32. I accept, however, Mr Wong's submission that the Statement can readily be rectified to cure the technical deficiency. Since I consider that the Taxpayer's proposed appeal is reasonably arguable, I do not believe it is right to dismiss the leave application outright without giving the Taxpayer an opportunity to amend the Statement.

33. In all the circumstances, I order and direct that:-

(1) The Taxpayer shall file in court and serve on the Commissioner a fresh statement in compliance with the requirements of Section 69(3)(a)(ii) of the Ordinance and paragraph 2(2) of Practice Direction 34 within 21 days.

(2) The Commissioner shall give notice of whether he has any objection(s) to the fresh statement, and give particulars of the objection(s) in the event that the statement is objected to, within 14 days of service of the same by the Taxpayer.

(3) In the event that the Commissioner does not object to the fresh statement within the period mentioned in (2) above, leave to appeal shall be granted to the Taxpayer under Section 69 of the Ordinance.

(4) In the event that the Commissioner shall object to the fresh statement within the period mentioned in (2) above, the matter shall be restored before the court for further argument.

34. On the issue of costs:-

(1) In the event that leave to appeal is granted under sub-paragraph (3) above, I make an order *nisi* that (i) 20% of the costs of the hearing on 1 November 2017, to be taxed if not agreed, be to the Commissioner and to be paid by the Taxpayer in any event, (ii) 80% of the costs of the hearing on 1 November 2017 and, save as provided above, the costs of and occasioned by the leave application, be in the cause of the appeal. There shall also be a certificate for two counsel in respect of the hearing on 1 November 2017.

(2) In the event that the question of leave to appeal shall have to be further considered under sub-paragraph (4) above, the question of costs shall also be dealt with at the next hearing.

35. Lastly, it remains for me to thank counsel for their assistance rendered to the court.

(Anderson Chow)
Judge of the Court of First Instance
High Court

Mr Stewart Wong, SC and Ms Bonnie Cheng, instructed by Squire Patton Boggs, for the appellant

Mr Eugene Fung, SC and Ms Zabrina Lau, instructed by Department of Justice, for the respondent