HCIA 2/2017
[2020] HKCFI 1649

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 Court
Dates of Hearing: 10 September & 11 December 2019
Date of Judgment: 28 July 2020

JUDGMENT

INTRODUCTION

1. This is the Appellant/Taxpayer's appeal under s 69(1) of the Inland Revenue Ordinance, Cap 112 ("**the IRO**") against the decision ("**the Decision**") of the Board of Review ("**the Board**") dated 17 January 2017, whereby the Board confirmed the additional profits tax assessments for the years of assessment 2009/10, 2010/11 and 2011/12 ("**the Assessments**") issued by the Commissioner to the Taxpayer.

2. The issue before the Board was whether the upfront, lump sum, spectrum utilization fees ("**the Upfront SUFs**") paid by the Taxpayer to the Telecommunications Authority ("**the TA**") were *revenue* in nature and hence deductible under s 16(1) of the IRO, or *capital* in nature and hence not deductible by reason of s 17(1)(c) of the IRO. The Board found that the Upfront SUFs were capital in nature, and thus not deductible.

3. For reasons which I shall endeavour to explain in this judgment, I am of the view that the Board is correct to find that the Upfront SUFs were capital in nature. Accordingly, the present appeal stands to be dismissed.

4. For the sake of consistency, unless otherwise expressly indicated, the expressions and abbreviations as defined in the Decision shall be adopted in this judgment.

BASIC FACTS

5. The background facts have been set out in the Decision, which I gratefully adopt for the purpose of this appeal[1].

> "[3] The facts set out below are based upon the Agreed Facts signed by the parties, the documents before this Board, and the background concerning the Upfront SUFs contained in the Appellant's witness' evidence.
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> [4] (a) The Taxpayer was incorporated in Hong Kong on 28 June 1994. It closed accounts annually on 31 December.
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> (b) At all material times, the principal activity of the Taxpayer was the provision of mobile telecommunication and related services in Hong Kong.
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> [5] (a) On 30 September 1996, the Taxpayer was awarded a licence for a term of 10 years for the provision of second generation ('2G') personal communications services in Hong Kong ('the PCS Licence'). In January 1997, the Taxpayer launched the 2G mobile services under a brand name and operated with 2 x 11.6 MHz bandwidth in the 1800 MHz radio frequency band.
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> (b) Upon the expiry of the PCS Licence, the Taxpayer was granted a mobile carrier licence with a term of 15 years (i.e. up to and including 29 September 2021) to continue its 2G operations in Hong Kong.
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> (c) On 30 September 2008, a unified carrier licence ('UCL') (Licence No.002) was issued to the Taxpayer to replace the mobile carrier licence.
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> [6] (a) The Taxpayer as a holder of mobile carrier licence was required to pay annual licence fees. The licence fees were set out on a cost-recovery basis to cover the operating

[1] Under s 69, leave to appeal must not be granted unless the Court of First Instance is satisfied, *inter alia*, that a question of law is involved in the proposed appeal. Under s 69AA(1)(b), where leave to appeal has been granted, the Court of First Instance, on hearing the appeal, must not (i) receive any further evidence or (ii) reverse or vary any conclusion made by the Board on questions of fact unless the Court of First Instance finds that the conclusion is erroneous in point of law.

costs of the Office of the TA (or its successor, the Office of the Communications Authority) in administering the licences.

(b) The annual SUF payable by the Taxpayer for the use of radio spectrum for its 2G operations was stipulated in the Telecommunications (Level of Spectrum Utilization Fees) (Second Generations Mobile Services) Regulation (Cap. 106AA).

[7] On 3 December 2007, the TA, by the document '*Providing Radio Spectrum for Broadband Wireless Access Services: Statement of the Telecommunications Authority*', proposed to allocate some frequency bands for the provision of broadband wireless access services. An auction ('the 4G Auction') would be conducted to determine the SUF (with a minimum set by the Secretary for Commerce and Economic Development), which would be in the form of an upfront lump sum. The conclusion reached by the Authority (stated at paragraph 67 of the said document) was that it would:

'recommend the SCED to make a regulation under section 32I(2) of the TO specifying that the SUF for the BWA spectrum will be determined by auction. The bidder who offers the highest bid will be the successful bidder. The SUF will be in the form of an upfront lump sum payment'.

[8] Before the 4G Auction, the Taxpayer was only operating 2G mobile services in Hong Kong and it was not a 3G operator at the time. In order to maintain its market position, the Taxpayer was eager to succeed in the 4G Auction because there was a concern that other mobile network operators would outbid the Taxpayer with a view to eliminating it from the market.

[9] The 4G Auction was completed on 22 January 2009. The Taxpayer was the successful bidder of one of the frequency bands. The SUF payable for the use of the bands was in the lump sum of HK$494,700,000.

[10] As a result of assignment of the 4G spectrum, the Taxpayer has enlarged its profit-earning structure and capacity by venturing into a new field of business and strengthening its market competitiveness.

[11] Separately, in 2008, the TA proposed to make available certain frequency bands to incumbent 2G licensees (of which the Taxpayer was one). At the time, the 2G licensees had been

assigned frequency bands for use in their 2G mobile network services, and the SUFs they were paying for the use of the bands were annual sums, with the first five years being at a rate per kHz assigned, and subsequent years at the higher of the per kHz rate or a sum calculated by reference to turnover. It was proposed that the annual SUFs for the use of the frequency bands to be assigned would be charged on the same basis because the frequency bands to be assigned would be incorporated into the existing 2G licences. However, it was proposed in the paper '*Assignment of the Available Radio Spectrum in the 900 MHz and 1800 MHz Bands: Consultation Paper*' (18 January 2008) that an additional, one-off lump sum component of the SUF be charged as well, for the following reason:

> '23. As mentioned in paragraph 17, the TA proposes to assign the frequencies by auction. For the purpose of the auction, the TA proposes to assign the frequencies to the successful bidder(s) who has/have offered the highest additional one-off lump sum SUF on top of the annual variable SUF described in paragraph 20 above. Such additional component of SUF will also be used to determine the respective priority rights of the successful bidders in choosing preferred set(s) of frequency bands. The bid will have to be equal to or greater than the reserve price set by the Secretary for Commerce and Economic Development ('SCED') for each frequency block. The reserve prices for all frequency blocks will be set at the same amount and it will be determined and announced nearer to the time of auction.
>
> 24. Following the approaches outlined above, the TA proposes that a two-tier SUF payment arrangement be adopted. The SUF will consist of two components: (a) an annual variable component based on the SUF calculation formula for the 2G spectrum under the existing 2G licences as described in paragraph 21 above and (b) a one-off lump sum component based on a sum committed by the successful bidder(s) in the forthcoming auction as described in paragraph 23.'

[12] In the relevant brief to the Legislative Council Panel on Information Technology and Broadcasting – '*Legislative Council Panel on Information Technology and Broadcasting: Assignment of the Available Radio Spectrum in the 1800 MHz Band*' (1 December 2008), it was said that the lump sum component would

'serve to determine the successful bidder(s) and the respective priority rights of the successful bidder(s) to choose the preferred set(s) of frequency bands.'

[13] Accordingly, the auction ('the 2G Auction') to be held was to determine the lump sum component of the SUF to be paid for the use of the bands, and which bidder would be assigned which frequency bands. The annual component of the SUF would be the same as that applicable to the then already assigned frequency bands to 2G licensees.

[14] The Taxpayer was the successful bidder of two of the frequency bands at the 2G Auction, which was completed on 10 June 2009. The total lump sum SUF payments were HK$15,120,000.

[15] On 10 March 2009, the Taxpayer paid the TA the upfront SUF committed in the 4G Auction in the sum of HK$494.7 million.

[16] On 31 March 2009, a UCL (Licence No.009) was issued to the Taxpayer.

[17] On 1 June 2009, a UCL (Licence No.002) was issued to the Taxpayer to replace the UCL (Licence No.002) issued on 30 September 2008 and the UCL (Licence No.009) issued on 31 March 2009.

[18] In June 2009, the Taxpayer paid the TA the upfront SUF committed in the 2G Auction in the sum of HK$15.12 million. The Taxpayer paid the said SUF by setting-off the cash deposit of HK$48 million made to the TA on its submission of application for participating in an auction in May 2009.

[19] On 26 June 2009, the UCL (Licence No.002) issued to the Taxpayer on 1 June 2009 was amended.

[20] The Taxpayer's success in the 2G Auction enlarged and strengthened its profit-yielding infrastructure by increasing its 2G spectrum capacity and improving the service quality of its 20 mobile services.

[21] The Taxpayer furnished Profits Tax Returns for the years of assessment 2009/10 to 2011/12 together with its audited financial statements and tax computations for the respective years ended 31 December 2009 to 2011. In the returns, the Taxpayer declared the following Assessable Profits after deducting, among other things, amortisation of the Upfront SUFs mentioned in paragraphs 9 and 14 above as follows:

	2009/10	2010/11	2011/12
	$	$	$
Assessable Profits	598,757,316	806,070,243	772,560,530
After deducting:			
Amortisation of the Upfront SUFs	25,368,699	34,212,877	34,212,877

[22] (a) The Taxpayer analysed its turnover for the years ended 31 December 2009 to 2011 as follows:

Year ended 31 December	2009	2010	2011
	$	$	$
Airtime and service charges	2,315,578,225	2,495,286,850	2,664,853,144
Sales of handsets and accessories	239,831,454	268,389,088	440,127,935
	2,555,409,679	2,763,675,938	3,104,981,079

(b) The Taxpayer recognised telecommunications service revenue when the service was rendered to customers on the basis of the usage of its digital mobile radio telephone network and facilities.

(c) 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.

(d) The amortisation of the Upfront SUFs for the years ended 31 December 2009 to 2011 was analysed as follows:

		Amortisation		
Licence Period	SUF $	2009 $	2010 $	2011 $
4G 31/3/2009-30/3/2014	494,700,000	24,735,000	32,980,000	32,980,000
2G 26/6/2009-29/9/2021	15,120,000	633,699	1,232,877	1,232,877

		Amortisation		
Licence Period	SUF $	2009 $	2010 $	2011 $
	509,820,000	25,368,699	34,212,877	34,212,877

[23] The Assessor raised on the Taxpayer Profits Tax Assessment for the years of assessment 2009/10 to 2011/12 in accordance with its returns. The Taxpayer did not object to the assessments.

[24] The Assessor opined that the Upfront SUFs were capital expenditure. Accordingly, he raised on the Taxpayer the following Additional Profits Tax Assessment ('the Assessments') for the years of assessment 2009/10 to 2011/12 to disallow the deduction of amortisation charge on the Upfront SUFs:

	2009/10 $	2010/11 $	2011/12 $
Additional Assessable Profits	25,368,699	34,212,877	34,212,877
Additional Tax Payable thereon	4,185,835	5,645,124	5,645,125

[25] The Taxpayer through its tax representatives objected to the Assessments.

[26] By a Determination dated 30 December 2014, the Deputy Commissioner of Inland Revenue confirmed the Assessments.

[27] By a Notice of Appeal dated 29 January 2015, the Taxpayer appealed to this Board against the Assessments."

THE DECISION

6. The Board made the Decision on the Appeal on 17 January 2017. At [53] and [58] of the Decision, the Board found that the Upfront SUFs were fees arising or resulting from the 4G Auction and the 2G Auction. The subject matters of the 4G Auction and the 2G Auction were the granting of the relevant UCLs, together with the right to use the specified frequency bands. 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.

7. At [70] of the Decision, the Board, applying the "indicia" as suggested in the authorities for distinguishing between capital and revenue expenditures (which I shall further discuss below), found that the Upfront SUFs were clearly capital in nature:

"(a) The Upfront SUFs were incurred once and for the right to use the specified frequency band(s) and the UCLs.

(b) The Upfront SUFs were paid with a view to bringing into existence an advantage for the enduring benefit of the Taxpayer's mobile telecommunications business in Hong Kong.

(c) The Upfront SUFs were the cost of enlarging, enhancing and strengthening the permanent profit-producing business structure of the Taxpayer and its income-generating capacity.

(d) The *Sun Newspapers*' 3 criteria[2]:

(i) Character of advantage sought: the Upfront SUFs were paid for the right to use the specified spectrums and the grant/amendment of the UCLs for the Taxpayer to operate its telecommunications business for a period of 15 years (in the case of 4G spectrum) and 12 years (in the case of 2G additional spectrum).

(ii) The manner in which it is to be used, relied upon or enjoyed: the Upfront SUFs were paid once and for all. There is no recurrence of paying the Upfront SUFs, as there is no legitimate expectation that there would be any right of renewal or right of first refusal of any licence or spectrum assignment upon the expiry of the licence or spectrum assignment: see Radio Spectrum Policy Framework §4.2.

(iii) The means adopted to obtain it - periodic payment or a final provision to secure future use: the Upfront SUFs were a final provision to secure the assignment of the specified spectrums and the grant of the relevant UCLs."

8. Having come to the conclusion that the Upfront SUFs were capital in nature, the Board went on to hold that they were not deductible by the operation of s 17(1)(c) of the IRO.

GROUNDS OF APPEAL

9. In the "Amended Statement of the Appellant ('Taxpayer') of the Grounds of Appeal and Reasons Why Leave should be Granted" dated 20 March 2018 ("**the Amended Statement**"), the Taxpayer contends that the Board has erred in concluding that the Upfront SUF payments are capital in nature in that they were paid for the grant of the relevant unified carrier licence together with the *right to use* radio spectrum (as distinct from being paid for the *use of* such spectrum) (see [7] of the

[2] (1938) 61 CLR 337, at 363 *per* Dixon J.

Amended Statement). A total 8 grounds of appeal are raised in support of this contention:

(1) The Board failed to have proper regard to, and erroneously interpreted, the provisions of the Telecommunications Ordinance, Cap 106 ("**the Ordinance**") and the relevant subsidiary legislation, which prescribe the payment of SUF and define its nature as being paid for *the use of* radio spectrum by the Taxpayer.

(2) The Board erroneously and without any proper basis found that it was not a purpose of the Ordinance "to give out *the right to* use radio spectrum free of charge and would only impose charges on the *actual use* of radio spectrum".

(3) The Board erroneously confused (i) the payment of the SUF as a *condition* for the assignment of the right to use the frequency bands with (ii) the payment of the SUF as *consideration* for the assignment of the said right.

(4) The Board has failed to give any or any proper regard to the circumstances of the change from the SUF being an annual royalty payment (which was accepted by the IRD to be revenue in nature) to upfront lump sum.

(5) The Board has failed to give proper regard to the fact that the IRD had accepted the annual SUF payments previously made by the Taxpayer as revenue in nature and deductible. The Board ought to have held that the change in the method of payment or the manner of calculating or fixing the amount of the SUFs did not change the nature thereof from revenue to capital, and the upfront SUFs remain revenue in nature as payments for the use of radio spectrum. Further or alternatively, the Board has failed to give any valid reasons for distinguishing between the annual SUF payments accepted as revenue and the upfront SUF payments over which the Assessments were raised.

(6) The Board has erred in taking the view that the "circulating capital test" does not assist the Taxpayer.

(7) The Board erroneously applied various Singaporean and South African authorities, namely, (i) *BFH v The Comptroller of Income Tax* [2013] 4 SLR 568, and (ii) *ITC 1726* (2000) 64 SATC 236, followed in *ITC 1772* (2003) 66 SATC 211, when each of these authorities is distinguishable from and as such inapplicable to the present case and the relevant legislative regime in Hong Kong.

(8) The Board has erred in its application of the indicia suggested in the authorities in that its analysis was premised on the incorrect notion that the upfront SUF is paid for the right to use the spectrum (as distinct from its actual use).

PRINCIPLES FOR DETERMINING WHETHER AN EXPENDITURE IS CAPITAL OR REVENUE IN NATURE

10. Section 14(1) of the IRO provides that, subject to the provisions of the Ordinance, profits tax shall be charged for each year of assessment on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with Part 4 of the IRO.

11. Section 16 of the IRO governs the ascertainment of a person's chargeable profits for the purpose of profits tax. Under s 16(1) of the IRO, "in ascertaining the profits in respect of which a person is chargeable to tax under this Part 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 …".

12. Section 17(1)(c) of the IRO goes on to provide that, for the purpose of ascertaining profits in respect of which a person is chargeable to tax, no deduction shall be allowed in respect of "*any expenditure of a capital nature or any loss or withdrawal of capital*".

13. Hence, an expenditure which is "capital", as opposed to "revenue", in nature cannot be deducted from the profits of a person for the purpose of computing his profits tax liability.

14. The following principles for determining whether an expenditure is capital or revenue in nature are well established.

15. First, the question of whether an expenditure is capital or revenue in nature is a question of law: *Wharf Properties Ltd v CIR* [1997] AC 505, at 510E-F *per* Lord Hoffmann; *Shui On Credit Co Ltd v CIR* (2009) 12 HKCFAR 392, at [38] *per* Lord Walker NPJ.

16. Second, there is no decisive test for determining whether an expenditure is capital or revenue in nature. The issue has to be approached by applying common sense from a practical and business point of view having regard to all relevant features of the case.

(1) In *Regent Oil Co Ltd v Strick* [1966] AC 295, at 312G-313G, Lord Reid stated as follows –

"Whether a particular outlay by a trader can be set against income or must be regarded as a capital outlay has proved to be a difficult question. It may be possible to reconcile all the decisions but it is certainly not possible to reconcile all the reasons given for them. I think that much of the difficulty has arisen from taking too literally general statements made in earlier cases and seeking to apply them to a different kind of case which their authors almost certainly did not have in mind - in seeking to treat expressions of judicial opinion as if they were words in an Act of Parliament. And a further source of difficulty has been a tendency in some cases to treat some one criterion as paramount and to press it to its logical conclusion without proper regard to other factors in the case. The true view appears to me to be that stated by Lord Macmillan in *Van den Berghs Ltd. v. Clark*[3]:

> 'While each case is found to turn upon its own facts, and no infallible criterion emerges, nevertheless the decisions are useful as illustrations and as affording indications of the kind of considerations which may relevantly be borne in mind in approaching the problem.'

One must, I think, always keep in mind the essential nature of the question. The Income Tax Act requires the balance of profits and gains to be found. So a profit and loss account must be prepared setting on one side income receipts and on the other expenses properly chargeable against them. In so far as the Act prohibits a particular kind of deduction it must receive effect. But beyond that no one has to my knowledge questioned the opinion of Lord President Clyde in *Whimster & Co. v. Inland Revenue Commissioners*[4], where, after stating that profit is the difference between receipts and expenditure, he said:

> 'the account of profit and loss to be made up for the purpose of *ascertaining that difference* must be framed consistently with the ordinary principles of commercial accounting so far as applicable ...'

So it is not surprising that no one test or principle or rule of thumb is paramount. The question is ultimately a question of law for the court, but it is a question which must be answered in light

[3] [1935] AC 431, 438-439.
[4] 1926 SC 20.

of all the circumstances which it is reasonable to take into account, and the weight which must be given to a particular circumstance in a particular case must depend rather on common sense than on strict application of any single legal principle."

(2) In *B P Australia Ltd v Commissioner of Taxation of the Commonwealth of Australia* [1966] AC 224, at 264E-F, Lord Pearce stated thus -

"The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a commonsense appreciation of all the guiding features which must provide the ultimate answer. Although the categories of capital and income expenditure are distinct and easily ascertainable in obvious cases that lie far from the boundary, the line of distinction is often hard to draw in border line cases; and conflicting considerations may produce a situation where the answer turns on questions of emphasis and degree. That answer:

> 'depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured employed or exhausted in the process':

per Dixon J. in *Hallstroms Pty. Ltd. v. Federal Commissioner of Taxation*[5]. As each new case comes to be argued felicitous phrases from earlier judgments are used in argument by one side and the other. But those phrases are not the deciding factor, nor are they of unlimited application. They merely crystallise particular factors which may incline the scale in a particular case after a balance of all the considerations has been taken."

17. Third, subject to the overarching principle that there is no single decisive test for determining whether an expenditure is capital or revenue in nature, the following are, nevertheless, some useful *indicia* which can assist in answering that question:

(1) whether the expenditure is incurred "once and for all", or is going to "recur every year": see *Vallambrosa Rubber Co Ltd v Farmer (Surveyor of Taxes)* (1910) 5 TC 529, at 536 *per* Lord Dunedin;

[5] (1946) 72 CLR 634, 648.

(2) whether the expenditure is incurred "with a view to brining into existence an asset or an advantage for the enduring benefit of a trade": see *British Insulated and Helsby Cables Limited v Atherton* [1926] AC 205, at 213-214 *per* Viscount Cave LC;

(a) for this purpose, a benefit is "enduring" if it is of a "permanent quality" (although its permanence may be short-lived) or has sufficient "durability"; it does not have to be "everlasting": see *Henriksen (Inspector of Taxes) v Grafton Hotel Ltd* [1942] 2 KB 184, at 192 *per* Lord Greene MR and 196 *per* du Parcq LJ;

(b) the length of time, although not a deciding factor, does in practice shed a light on the nature of the advantage sought - "[t]he longer the duration of the agreements, the greater the indication that a structural solution was being sought": see *B P Australia Ltd*, *ante*, at 267E-F;

(3) whether the expenditure relates to the cost of "creating, acquiring or enlarging the permanent… structure of which the income is to be the produce or fruit" on the one hand, or "earning that income itself or performing the income-earning operations" on the other: see *Wharf Properties Ltd*, *ante*, at 510F-H. Other ways of expressing the same idea is to ask whether the expenditure is incurred to acquire a "capital equipment or establishment", or "profit-earning apparatus", or the "means of production" (as opposed to the "use of them"): see *Robert Addie & Sons' Collieries Ltd v CIR* (1924) 8 TC 671, at 677 *per* Lord President Clyde; *RTZ Oil and Gas Ltd v Elliss* [1987] 1 WLR 1442, at 1453F *per* Vinelott J; *AusNet Transmission Group Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia* (2015) 255 CLR 439, at [73] *per* Gageler J.

18. In *Sun Newspapers Ltd v The Federal Commissioner of Taxation* (1938) 61 CLR 337, at 363, Dixon J referred to 3 matters for considering whether an item of expenditure is capital or revenue in nature which have been adopted in many subsequent cases for the purpose of analysis:

> "There are, I think, three matters to be considered, (a) the character of the advantage sought, and in this its lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and (c) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the

> payment or by making a final provision or payment so as to secure future use or enjoyment."

RADIO SPECTRUM

19. "Radio spectrum" is defined in s 2(1) of the Ordinance to mean the "range of frequencies within which telecommunications are capable of being carried out". For the present purpose, it is important to note that radio spectrum is not a tangible thing or matter. It is, instead, the "medium" through which radio waves travel, or are transmitted and received, between radiocommunications transmitting apparatus[6]. In the Communications and Technology Branch's Consultation Paper on Proposed Spectrum Policy Framework dated October 2006 ("**the 2006 Consultation Paper**"), the following explanation of radio spectrum is given:

> "Radio spectrum, referred to in this consultation paper as 'spectrum', is an important, intangible and scarce public resource for telecommunications, broadcasting and other purposes. By modulating electromagnetic waves at certain radiofrequencies, radiocommunications equipment can send messages from one place to another without the need for any physical wiring linking the two places.
>
> [4] Thus, the availability of spectrum is important to the operation of many radiocommunications networks, services and equipment. Spectrum can be considered as a medium in which many wireless applications are run and many day-to-day activities are supported. It can be considered a critical input for future innovation and growth in the communications sector …".

Hence, although it may sometimes be convenient to speak of an "assignment of spectrum" by the Authority to a spectrum user, that expression should be read or understood as a short-hand for an "assignment of the right to use spectrum".

20. It is also important to note that, but for the regulation of the use of spectrum imposed by the Ordinance, spectrum can be "accessed by anyone, anywhere, and would not exclude others from using the same resource (although interference may occur in some situations)"[7]. Due to this potential for interference, the use of spectrum cannot be left entirely unregulated. As stated in [6] of the 2006 Consultation Paper, "[i]f there were no consensus or control over who can use which part of the spectrum at what geographic location for what purposes, each spectrum user will try to increase his transmission power so that his transmission would overpower other competing transmissions. Such behaviours would lead to unacceptable levels of radio interference."

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[6] See the definitions of "radio waves", "radio transmitter", "radiocommunications installation" and "radiocommunications transmitting apparatus" in s 2(1) of the Ordinance.

[7] See [5] of the 2006 Consultation Paper.

SPECTRUM UTILIZATION FEE

21. In Hong Kong, the use of radio spectrum is governed and regulated by the Ordinance. Under s 32H(1) of the Ordinance, the Communications Authority ("**the Authority**"), established by s 3 of the Communications Authority Ordinance (Cap 616) as the successor to the TA, may assign frequencies and bands of frequencies in all part of the radio spectrum used in Hong Kong. Under s 32H(2)(c) of the Ordinance, the Authority may assign the frequencies or bands of frequencies to users of radiocommunications apparatus and specify the purpose for which and the conditions under which the frequencies or bands of frequencies are to be used. Section 32H(5) prohibits any person from using in Hong Kong a frequency in any part of the radio spectrum unless the frequency is assigned, or located within a band of frequencies assigned, by the Authority or the use is for the purpose and in compliance with the conditions specified by the Authority.

22. Under s 32H(6) of the Ordinance:

> "Where an assignment which may be made under subsection (1) relates to the use of spectrum which under section 32I is subject to the payment of spectrum utilization fee –
>
> (a) by the user of the spectrum; and
>
> (b) the method for determining which is prescribed under section 32I(2)(b),
>
> then the Authority may, in determining applications for the assignment, regard the fees, if any, arising or resulting from that method as a determining factor in relation to those applications."

23. Section 32I of the Ordinance contains provisions concerning the payment of, and method for fixing, spectrum utilization fee, and states, so far as relevant, as follows:

> "(1) 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.
>
> (2) The Secretary may by regulation prescribe -
>
> (a) the level of spectrum utilization fees; or
>
> (b) the method for determining the spectrum utilization fees, which may be by –

(i) auction or tender or a combination of auction and tender; or

(ii) such method as the Secretary thinks fit, including any method combined with a method mentioned in subparagraph (i).

(3) A spectrum utilization fee may be calculated on the basis of a royalty or any other basis that includes an element in excess of the simple recovery of the cost of providing a service by the Authority."

24. Section 32I(11) of the Ordinance further provides that spectrum utilization fee includes "a fixed fee, a fee calculated by a formula or a fee ascertained by another method, or any combination thereof".

25. In short, before any telecommunication service provider like the Taxpayer can use any particular frequencies or bands of frequencies of the radio spectrum for the purpose of providing telecommunication services to its customers, it must first obtain a relevant assignment from the Authority, and such assignment may be (and, in practice since 2001[8], has been) subject to the payment of such spectrum utilization fee as may be prescribed by the Secretary under s 32I(2)(a), or determined pursuant to the method prescribed under s 32I(2)(b), of the Ordinance.

26. In the present case:

(1) In the Notice of Terms and Conditions relating to the 4G Auction dated 3 October 2008 ("**the 4G Notice**"), the following is stated:

(a) The TA, in exercise of his powers conferred by s 32I of the Ordinance, issues the notice to specify the terms and conditions of the auction of "*the right to use the frequency bands specified in this Notice and the payment of the spectrum utilization fees*" (page 1).

(b) The purpose of the notice is to specify, *inter alia*, "*the terms and conditions of the Auction and the payment of Spectrum Utilization Fees*" (Clause 1.2.1(a)).

(c) The expression "Spectrum Utilization Fees" is defined to mean "*the sum payable in respect of the use of a Frequency Band as determined in accordance with the Notice*" (Clause 1.4.1).

[8] Save in relation to spectrum assigned administratively.

(d) Within 30 business days after publication of the Provisional Successful Bidder Notice, each Provisional Successful Bidder "*shall pay to the Authority in cash the Spectrum Utilization fee payable by it*" (Clause 5.2.1(a)).

(e) Where a Provisional Successful bidder fails to comply with the requirements specified in Clause 5.2.1, the Authority "*shall not grant a Licence to the Provisional Successful Bidder…*" (Clause 5.2.3).

(f) After, amongst other matters, complying with the requirements specified in Clause 5.2.1, the Authority "*shall … grant a Licence to the Successful Bidder under which the Frequency Band or Frequency Bands for which that Bidder is the Successful Bidder shall be assigned*" (Clause 5.4.1).

(2) Similar provisions can be found in the Notice of Terms and Conditions relating to the 2G Auction dated 24 April 2009 ("**the 2G Notice**"):

(a) The TA, in exercise of his powers conferred by s 32I of the Ordinance, issues the notice to specify the terms and conditions of the auction of "*the right to use the frequency bands specified in this Notice and the payment of the spectrum utilization fees*" (page 1).

(b) The purpose of the notice is to specify, *inter alia*, "*the terms and conditions of the Auction and the payment of Spectrum Utilization Fees*" (Clause 1.2.1(a)).

(c) The expression "Spectrum Utilization Fee" is defined to mean "*the spectrum utilization fee payable by the user of a Frequency Band as prescribed in section 2(2) of the Telecommunications (Level of Spectrum Utilization Fees) (Second Generation Mobile Services) Regulation (Cap. 106AA)*", and the expression "Upfront Spectrum Utilization Fee" is defined to mean "*the fixed fee … which forms part of the Spectrum Utilization Fee …*" (Clause 1.4.1).

(d) Within 15 business days after publication of the Provisional Successful Bidder Notice, each Provisional Successful Bidder "*shall pay to the Authority in cash the Upfront Spectrum Utilization Fee payable by it*" (Clause 5.2.1).

(e) Where a Provisional Successful bidder fails to comply with the requirements specified in Clause 5.2.1, the Authority "*shall not assign any Frequency Band to that Provisional Successful Bidder…*" (Clause 5.2.3).

(f) After, amongst other matters, complying with the requirements specified in Clause 5.2.1, the Authority "*shall … assign to the Successful Bidder the Frequency Band or Frequency Bands for which that Bidder is the Successful Bidder*" (Clause 5.4.1).

(3) The Taxpayer paid the Upfront SUF of HK$494.7 million committed in the 4G Auction on 10 March 2009 and the Upfront SUF of HK$15.2 million committed in the 2G Auction in June 2009 to the TA, in return for which the Taxpayer became entitled to use, or was granted the right to use, the 4G spectrum for a period 15 years and the additional 2G spectrum for a period of about 12 years.

(4) In UCL No 009 issued to the Taxpayer dated 31 March 2009, it is provided that:

(a) "*Each radiocommunications installation operated by or on behalf of the licensee shall be used only at the location and with emissions and at the frequencies and of the classes and characteristics specified in Schedule 3 to this licence …*" (Clause 12.1 of General Conditions).

(b) "*The radiocommunications installation operated by or on behalf of the licensee shall only be operated on such frequencies as the Authority may assign*" (Clause 13.1 of General Conditions).

(c) "*On the date of issue of this licence, the licensee shall have paid spectrum utilization fees ("SUF") for use of the spectrum designated by the Authority to be subject to SUF and assigned to the licensee, at such level as determined by auction*" (Clause 29.1 of Special Conditions).

(d) Schedule 3 specifies, *inter alia*, the frequency bands (2555-2570 MHz and 2675-2690 MHz) of spectrum assigned by the Authority to the licensee for operation of its radiocommunications installation.

(5) Similarly, in UCL No 002 issued to the Taxpayer dated 1 June 2009 as amended on 26 June 2009, it is provided that:

(a) "*Each radiocommunications installation operated by or on behalf of the licensee shall be used only at the location and with emissions and at the frequencies and of the classes and characteristics specified in Schedule 3 to this licence …*" (Clause 12.1 of General Conditions).

(b) "*The radiocommunications installation operated by or on behalf of the licensee shall only be operated on such frequencies as the Authority may assign*" (Clause 13.1 of General Conditions).

(c) "*The licensee shall pay Spectrum Utilization Fees for spectrum assigned to the licensee as designated by the Authority by order and at such level or according to the method of determining the Spectrum Utilization Fees as prescribed by the Secretary by regulation. The licensee shall pay the Spectrum Utilization Fee to the Authority during the period while the licence remains in force…*" (Clause 29.1 of Special Conditions).

(d) Schedule 3 specifies, *inter alia*, the frequency bands of spectrum assigned by the Authority to the licensee for operation of its radiocommunications installation, as well as the terms of the assignments.

27. Upon a consideration of the legislative regime under the Ordinance and looking at the matter from a practical, business and common sense point of view, I consider it to be clear that the Upfront SUF was the consideration, or price, which the Taxpayer had to pay in order to be able to use the designated spectrum. In other words, the Upfront SUF was paid for the right to use the designated spectrum. Further, the Upfront SUF was payable by the Taxpayer regardless of whether it actually used, or made use of, the spectrum, and regardless of the extent of its use of the same.

28. At [58] of the Decision, the Board found that:

> "…the subject matter of the 4G Auction and the 2G Auction was the granting of the relevant UCL, together with the right to use the specified frequency bands. 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."

In my view, this finding of the Board fairly describes the nature and character the Upfront SUFs paid by the Taxpayer to the Authority in this case, and is correct.

THE UPFRONT SUFS WERE CAPITAL EXPENDITURES

29. I am of the view the Upfront SUFs were capital in nature, for the following reasons:

(1) The Upfront SUFs were paid by the Taxpayer with a view to acquiring the right to use certain specified frequency bands in the 4G spectrum or additional frequency bands in the 2G spectrum (here, I use the expression "right to use" in a general, and not any technical, sense, and I shall consider the distinction between "right to use" and "use" as drawn by the Taxpayer later in this judgment). The specified frequency bands in the 4G spectrum or additional frequency bands in the 2G spectrum so acquired were part of the necessary and permanent profit-earning structures required by the Taxpayer to venture into a new line of business (namely, the provision of 4G services), or expand and strengthen its existing line of business (namely, the provision of 2G services), thereby boosting it income-generating capacity.

(2) The specified or additional frequency bands in the 4G/2G spectrums so acquired by the Taxpayer from making the Upfront SUFs would bring about enduring benefits to the business of the Taxpayer, in that it could provide 4G/additional or enhanced 2G services to its customers for the next 15 years/12 years.

(3) The Upfront SUFs were lump sum payments incurred once and for all, instead of periodic payments to meet an ongoing demand for expenditure.

THE DISTINCTION SOUGHT TO BE DRAWN BY THE TAXPAYER BETWEEN A PAYMENT FOR THE (I) "RIGHT TO USE" AND (II) "USE" OF SPECTRUM

30. At the heart of this appeal is the Taxpayer's contention that the Upfront SUFs were paid for the use of, as opposed to the right to use, radio spectrum and therefore were revenue in nature. As stated in [18] of Mr Ronny Wong, SC's Submissions for the Taxpayer dated 30 August 2019 -

> "In summary, the Appellant's case, to be developed in this Skeleton, is that the concept, nature and purpose of spectrum utilization fee is set out and defined by statute, i.e. section 32I(1) of the TO, which states that it is to be paid for the *use* of spectrum, and not for the *right to use* the spectrum, or the assignment of any such right, or for the grant of any carrier licence. In the legislative scheme for the management of spectrum under Part 5B, the TO has carefully adopted '*use of spectrum*' as the central theme, and has refrained from making any reference to '*the right to use*' at all." [emphasis original]

31. At [27.1] of those submissions, it is further stated that -

> "The primary issue dividing the Appellant and CIR is whether the Upfront spectrum utilization fees were paid for (i) the grant of the UCLs together with ***the right to use*** or (ii) ***the use*** of spectrum. If the former, the payment is ***capital***, and if the latter, the payment is ***revenue***. If, as the CIR contends, and as the Board held, the Upfront spectrum utilization fees were paid for the right to use the spectrum and for the UCL, the Authority would be acting ultra vires, as it would be receiving the spectrum utilization fees for a purpose other than that for which the TO prescribes." [emphasis original]

32. In support of the suggested distinction between payment for (i) the right to use, and (ii) the use of, spectrum, the Taxpayer relies heavily on the judgment of the House of Lords, in particular that of Lord Morris Borth-y-Gest, in *Regent Oil Co Ltd v Strick (Inspector of Taxes)* [1966] AC 295. In that case, a company made arrangements with a number of petrol retailers to secure exclusive sales of its products at their service stations. Under each arrangement the retailer leased his premises to the company for a term of years at a nominal rent in return for a lump sum, which was called a "premium" but was calculated on the basis of the estimated gallonage of petrol to be supplied to the retailer during the term of the lease. Simultaneously the company sublet the premises back to the retailer at a nominal rent for the same term less three days. The retailer covenanted, *inter alia*, to use the premises as a garage and petrol filling station, to take all his oil supplies from the company and not to assign except in favour of an assignee who undertook to enter into similar covenants. There was provision for forfeiture on breach of covenant by the retailer if he fell into financial difficulties. In each case the lease, sublease and supplemental documents, if any, formed a single transaction.

33. The question which arose for determination was whether the premiums paid by the company to the retailers were capital in nature and therefore not properly deductible in computing its profits for income tax purposes. It was held by the House of Lords that the premiums paid by the company in order to acquire the leases were payments for the acquisition of assets for the purpose of carrying on a trade thereon and were therefore capital payments. At 329B-G, Lord Morris stated as follows:

> "The process of description as opposed to that of definition may sometimes be aided by noting contrasts. There is a difference between a business entity, structure or organisation set up or established for the earning of profit and the process by which such an organisation operates to obtain regular returns by means of regular outlay. There is a difference between the profit yielding subject and the process of operating it. There is a difference between the instrument for earning profits and the continuous process of its use or employment for that purpose. These contrasts were noted in 1938 by Dixon J. in his judgment in *Sun Newspapers Ltd. v. Federal Commissioner of Taxation.* In much the same way in 1946 in his judgment in *Hallstroms Property Ltd. v. Federal Commissioner of Taxation,* Dixon J. distinguished

> between the acquisition of the means of production and the use of them: between establishing or extending a business organisation and carrying on the business: between the implements employed in work and the regular performance of the work in which they are employed: between the enterprise itself and the sustained effort of those engaged in it. In his judgment in that case Starke J., while emphasising that none of the so-called definitions or tests or any other definitions or tests suggested by the cases are decisive, pointed out that an asset or advantage need not have a tangible existence and expressed the view that expenditure to acquire the goodwill of a business or to acquire restrictive covenants against competition in business may be of a capital nature. In agreement with what was said by Starke J., I consider that no different result is reached according as to whether an asset or advantage is of a tangible or of an intangible nature."

34. At [53] of Mr Wong's Submissions, immediately following the above quoted passage from the judgment of Lord Morris, the following is said:

> "It is submitted that the difference between payment to acquire an asset or a right or an advantage forming part of the profit-earning structure of a business, and payment relating to the operation of the regular income-producing process of the business is neatly illustrated by the difference between the treatment, in the context of a lease, of a premium and rent. Where a sum is paid not for the use of the premises but is paid as a lump sum for access to the premises, i.e. in the nature of a premium to acquire the right to the future use of the premises under a lease, the sum is not rent (as it is not for use), and is a capital expenditure".

35. The footnote to this submission refers to various passages in the judgments of Lord Morris, Lord Upjohn and Lord Wilberforce in *Regent Oil*. It is not necessary to refer to all of them, save what was said by Lord Morris at 334B-E which may be regarded as being most favourable to the Taxpayer's contention[9]:

> "There 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. In the latter case the periodic payments (being periodic payments for the use of premises) would probably be payments of a revenue nature. In such a case the right itself to go on occupying the premises (subject to making the periodic payments or subject to conditions) might be or become of considerable value. It would be a capital asset - but as no lump sum price would have

[9] The other passages relied upon by the Taxpayer are at 341D-342B *per* Lord Upjohn, and 348G *per* Lord Wilberforce.

> been paid for it there would be no payment of a capital nature: there would be no payment calling for any inquiry."

36. Three points in respect of this passage in the judgment of Lord Morris in *Regent Oil* may be made here:

> (1) The distinction drawn between a lump sum payment (in the nature of a premium) and periodic payments (in the nature of rent) was in the context of a land lease. This distinction was said to be axiomatic "in the field of real property in relation to taxation" (see page 341B *per* Lord Upjohn). It does not necessarily follow that in every case a distinction should be drawn between a payment for (i) the use of, and (ii) the right to use, an asset for the purpose of determining whether the payment is capital or revenue.
>
> (2) In respect of the supposed distinction between premium and rent, Lord Reid said, at 315G-316A, the following: "It was argued that a rent and a premium paid under a lease are paid for different things - that the premium is paid for the right but that the rent is paid for the use of the subjects during the year. I must confess that I have been unable to understand that argument. Payment of a premium gives just as much right to use the subjects as payment of a rent and an obligation to pay rent gives just as much right to the whole term of years as payment of a premium."
>
> (3) There was no disagreement in the House of Lords that there was no single test for determining whether a payment was capital or revenue in nature, and that the question must be answered in light of all relevant circumstances of the case (see pages 313F-G *per* Lord Reid, 327F-328C *per* Lord Morris, 343E-F and 345B-E *per* Lord Upjohn, and 348B-G *per* Lord Wilberforce).

37. It is, in my view, wrong in principle to treat the distinction between a payment made for (i) the "right to use", and (ii) the "use of" spectrum as being decisive of whether the payment is capital or revenue in nature. As stated by Dixon J in *Hallstroms Proprietary Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634 at 648 -

> "What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process."

38. As earlier noted, one should apply a common sense, practical and business approach in determining whether an item of expenditure is capital and revenue in

nature. The danger of relying upon nice legal distinctions has led the Taxpayer in this case to fasten upon specific words, or forms of words, used in various statutory provisions as showing that the Upfront SUFs were paid for the use of, as opposed to the right to use, spectrum (when there is no reason to believe that the authors had any such distinction in mind), and then use such distinction as the basis for the argument that the Upfront SUFs were revenue in nature. I shall come back to the relevant statutory provisions relied upon by the Taxpayer when I consider the related grounds of appeal below. It can be seen from the Amended Statement that most, if not all, of the grounds raised by the Taxpayer in this appeal are based, ultimately, on the contention that a decisive distinction can and should be drawn between a payment made for (i) the right to use, and (ii) the use of, spectrum. I do not accept this contention.

GROUND 1: THE BOARD FAILED TO HAVE PROPER REGARD TO, AND ERRONEOUSLY INTERPRETED, THE PROVISIONS OF THE ORDINANCE AND RELEVANT SUBSIDIARY LEGISLATION

39. Under this ground, the Taxpayer refers to and relies on various statutory provisions which, it is said, show that the Upfront SUFs were paid for the use of radio spectrum, including:

(1) Section 32G(1) of the Ordinance, which states that the Authority shall promote the efficient allocation and "use of the radio spectrum" as a public resource of Hong Kong;

(2) Section 32I(1) of the Ordinance, which states that, subject to certain consultation obligation, "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";

(3) Section 2 of the Telecommunications (Designation of Frequency Bands subject to Payment of Spectrum Utilization Fee) Order, Cap 106Y (made pursuant to s 32I(1) of the Ordinance), which states that: "The frequency bands set out in the Schedule are designated as the frequency bands in which the use of spectrum is subject to the payment of spectrum utilization fee by the users of the spectrum";

(4) Section 2(1) and (2) of the Telecommunications (Level of Spectrum Utilization Fees) (Second Generation Mobile Services) Regulation, Cap 106AA, which provides for the determination of the spectrum utilization fees to be paid by the users of certain specified frequency bands of the spectrum; and

(5) Sections 3(1A) & (1) and 5 of the Telecommunications (Determining Spectrum Utilization Fees by Auction) Regulation, Cap 106AC, which provide for the determination of the

> spectrum utilization fees of certain specified frequency bands by way of auction.

40. Of these provisions, s 32I(1) of the Ordinance is most strongly relied upon by the Taxpayer as supporting the contention that the Upfront SUFs were payments made for the use of the assigned spectrum. However, this provision, read in an ordinary and natural way, seems to me to mean simply that a person is required to pay spectrum utilization fee in order to be able to use the spectrum the frequency bands of which have been designated by the Authority and are to be assigned to that person. The phrase "the use of spectrum is subject to the payment of spectrum utilization fee" is consistent with either the notion that a spectrum utilization fee is required to be paid for the right to use spectrum or the notion that a spectrum utilization fee is required to be paid for the use of the spectrum. In common parlance, there is no real difference between saying that (i) a payment is required to be made for the right to use an asset, and (ii) a payment is required to be made for the use of that asset. Even if, for some specific purposes or in some specific contexts, a nice distinction may be drawn between these forms of words, there is no reason to believe that the legislature had such distinction in mind when enacting s 32I of the Ordinance, or any of the statutory provisions relied upon by the Taxpayer.

41. Furthermore, even if one proceeds on the basis that the said provisions should be construed to mean that spectrum utilization fee is required to be paid for the use of spectrum, such construction does not answer the question of whether the payment of spectrum utilization fee is capital or revenue in nature for profits tax purpose. As earlier mentioned, there is no single decisive test to differentiate between capital and revenue.

42. In all, I do not accept the Taxpayer's construction of the statutory provisions relied upon by it. Neither do I accept that the true construction of those provisions can provide the answer to the question of whether the Upfront SUFs paid by the Taxpayer were capital or revenue in nature.

GROUND 2: THE BOARD ERRONEOUSLY AND WITHOUT ANY PROPER BASIS FOUND THAT IT WAS NOT A PURPOSE OF THE ORDINANCE "TO GIVE OUT THE RIGHT TO USE RADIO SPECTRUM FREE OF CHARGE AND WOULD ONLY IMPOSE CHARGES ON THE ACTUAL USE OF RADIO SPECTRUM"

43. The Taxpayer's criticism under this ground targets the Board's comment at [52] of the Decision that it did not "think that the TO has a purpose of giving out *the right to use* radio spectrum free of charge and would only charge *on the actual use of* radio spectrum."

44. In order to properly consider the validity of this criticism, it is necessary to have regard to the context in which the comment was made, namely, as part of the consideration of the Taxpayer's argument that there was a "short answer" to the question of whether the Upfront SUFs were capital or revenue in nature. In the Decision, the Board stated the following:

"[44] Mr Steward Wong SC (leading Ms Bonnie Cheng) on behalf of the Taxpayer submits that there is a short answer to the issue in this appeal - that short answer lies in s.32I(1) of the TO.

[45] Section 32I(1) of the TO provides …

[46] Mr Wong SC submits that the wording of the section is clear - the Upfront SUFs is paid *for the use* of the radio spectrum, *not for the right to use* the radio spectrum. Accordingly, the Upfront SUFs are expenditure which is revenue and not capital in nature.

[47] Mr Eugene Fung SC (leading Ms Zabrina Lau) on behalf of CIR submits that the point made by Mr Wong cannot be a short answer to the issue in this appeal. Mr Fung SC submits:

(a) The section does not say that the Upfront SUF is paid for the actual use of the spectrum. The phrase '*the use of spectrum is subject to the payment of spectrum utilization fee*' simply means that a user is required to pay SUF before it can legitimately use the designated frequency assigned to it. The word 'use' is used in the general sense (as in 'make use of', 'deploy' or 'utilise') without any special meaning in it.

(b) Further, to say that a payment is for the use of X does not tell you whether the payment is capital or revenue in nature. This can be illustrated by this simple example. A payment is described to be for the use of the land. However, such a payment can be a premium paid for a lease (which produces an asset for future use and is a capital payment) and rent under a lease (which is for current use and is a revenue payment).

[48] We agree with Mr Fung SC.

[49] In ascertaining the true meaning of a statutory provision, apart from the wording of the statute, the purpose of the statute must also be borne in mind. Mr Wong SC's submission, if correct, would mean that a purpose of the TO is to give out *the right to use* radio spectrum free of charge and would only impose charges on the *actual use* of radio spectrum. In our view, this is not a purpose of the TO.

[50] Our view is supported by s.32H(6) of the TO, which provides:

> 'Where an assignment which may be made under subsection (1) relates to the use of spectrum which may be made under section 32I is subject to the payment of spectrum utilization fee –
>
> (a) by the user of spectrum; and
>
> (b) the method for determining which is prescribed under section 32I(2)(b),
>
> then the Authority may, in determining the applications for the assignment, regard the fees, if any, arising or resulting from that method as a determining factor in relation to those applications.'

> [51] Pursuant to s.32H(6) of the TO, in determining the applications for assignment of radio spectrum, the TA may regard the SUF proposed by each applicant as a determining factor. Clearly, SUF may well be relevant to the assignment of radio spectrum.

> [52] We do not think that the TO has a purpose of giving out *the right to use* radio spectrum free of charge and would only charge on the *actual use* of radio spectrum. On the contrary, we take the view that the TO authorizes the TA to make the Upfront SUFs … as a condition for the assignment of the relevant radio spectrum."

45. For the reasons mentioned in [30] - [38] above, I do not accept the Taxpayer's argument that s 32I(1) of the Ordinance, whether in its terms or upon its true construction, provides a "short answer" to the question of whether the Upfront SUFs paid by the Taxpayer were capital or revenue in nature. Furthermore, regardless of whether the effect of Mr Wong's submissions before the board was that "a purpose of the Ordinance is to give out *the right to use* radio spectrum free of charge and would only impose charges on the *actual use* of radio spectrum" as mentioned in [49] of the Decision, there is no basis to argue that that it <u>is</u> in fact <u>a purpose</u> of the Ordinance to (i) give out the right to use radio spectrum free of charge, or (ii) only charge on the actual use of radio spectrum. On the contrary:

(1) Sections 32H(6) and 32I of the Ordinance plainly contemplate that an assignment relating to the use of spectrum may be subject to payment of spectrum utilization fee.

(2) There is nothing in the Ordinance to suggest that the obligation to pay upfront SUF would only arise upon actual use of the assigned spectrum. As a matter of fact, the 4G Notice and 2G Notice expressly provided that the assignment of the right to use the specified frequency bands, or the granting of a UCL, was conditional upon payment of the Upfront SUF. In other words, the Upfront SUF was payable before, and regardless of whether, the Taxpayer made use of the spectrum (to be assigned).

46. In any event, I do not see that the Board's comment at [52] of the Decision affects its analysis of whether the Upfront SUFs in this case were capital or revenue in nature. The Board's reasoning that the Upfront SUFs were capital in nature is to be found in [70] of the Decision, which is not dependent on its view that it was not a purpose of the Ordinance to give out the right to use radio spectrum free of charge, or only charge on the actual use of radio spectrum.

GROUND 3: THE BOARD ERRONEOUSLY CONFUSED (I) THE PAYMENT OF THE SUF AS A CONDITION FOR THE ASSIGNMENT OF THE RIGHT TO USE THE FREQUENCY BANDS WITH (II) THE PAYMENT OF THE SUF AS CONSIDERATION FOR THE ASSIGNMENT OF THE SAID RIGHT

47. This ground seeks to draw on a distinction between (i) the payment of the SUF as a condition for the assignment of the right to use the designated spectrum, and (ii) the payment of the SUF as consideration for the assignment of the said right. I have already explained why I do not consider the answer to the question of whether the Upfront SUFs were capital or revenue in nature depends on any such nice, technical, distinction.

48. I have also considered the nature and effect of the relevant provisions in the 4G/2G Notices and the related UCL Nos 009/002 in [26] to [28] above, and expressed my agreement with the Board's finding at [58] of the Decision that "[b]y 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". The payment of the Upfront SUF was a condition for the grant of a licence incorporating the assignment of the right to use the designated spectrum (see clause 5.2.3 of the 4G Notice), or for the assignment of the right to use designated spectrum (see clause 5.2.3 of the 2G Notice). This much is not disputed by the Taxpayer. The Upfront SUF can also be regarded, in my view, as the consideration (or part of the consideration) for the assignment of the right to use the designated spectrum. I do not consider that the Board has erroneously confused the two concepts.

GROUND 4: THE BOARD HAS FAILED TO GIVE ANY OR ANY PROPER REGARD TO THE CIRCUMSTANCES OF THE CHANGE FROM THE SUF BEING AN ANNUAL ROYALTY PAYMENT (WHICH WAS ACCEPTED BY THE IRD TO BE REVENUE IN NATURE) TO UPFRONT LUMP SUM

49. Grounds 4 and 5 can be considered together. In summary, the Taxpayer's argument is as follows[10]:

(1) It is evident from various consultation papers, statements and information memoranda of the Authority[11] that -

[10] See [11]-[12] of the Amended Statement.

(a) The initial considerations as to why the SUF was to be paid by way of annual royalty payments based on turnover subject to a minimum amount were economic and business considerations.

(b) The decision to switch to a single lump sum payment in 2007 was driven by the Authority's considerations that the initial economic and business justifications were no longer applicable, and that the mechanism of one-off lump sum payment would be simpler and easier to administer.

(c) The considerations and reasons for change had therefore nothing to do with the nature of the payment or what an entity assigned with a spectrum for use was paying for by way of SUF. The change was driven by economic and business considerations and administrative convenience.

(2) The Upfront SUFs were "pre-paid sum for the use of the frequency bands to be assigned under the UCL" and "a condition precedent to the grant (or amendment) of the UCL", and not payments for the grant or amendment or assignment of the frequency bands.

(3) The Board ought to have held that the change in the method of payment or the manner of calculating or fixing the amount of the SUFs did not change the nature thereof from revenue to capital, and the Upfront SUFs remained revenue in nature as payments for the use of radio spectrum.

(4) Further, the Commissioner had previously accepted the annual SUF payments made by the Taxpayer as revenue in nature and deductible, but the Board has failed to give any valid reasons for distinguishing between the annual SUF payments accepted as revenue and the Upfront SUF payments over which the Assessments were raised as capital.

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[11] Including (i) "Licensing of Mobile Services on Expiry of Existing Licences for Second Generation Mobile Services: Statement of the Telecommunications Authority" (29 November 2004), (ii) "Licensing of Spectrum in the 850 MHz Band to Enable the Provision of CDMA2000 Service: Consultation Paper" (27 October 2006), (iii) "Licensing of Spectrum in the 850 MHz Band to Enable the Provision of CDMA2000 Service: Statement of the Telecommunications Authority" (27 April 2007), (iv) "Providing Radio Spectrum for Broadband Wireless Access Service: Third Consultation Paper" (11 May 2007), and (v) "Spectrum Utilization Fee for Spectrum Assigned Administratively: Consultation Paper" (26 November 2010).

50. The documents relied upon by the Taxpayer referred to in [49(1)] above show that:

(1) Originally, no SUF was payable by 2G licensees for the assignment of spectrum.

(2) The requirement of a payment of SUF for assignment of spectrum was first imposed by the Authority in 2001 when 3G licences for mobile networks were granted in Hong Kong by means of an auction. In relation to that licensing exercise, the licensees were required to make payment of SUF on an annual, royalty, basis, based on a percentage of the turnover subject to a minimum amount.

(3) The rationale for adopting the royalty basis at that time was to lower the financial burden of the successful 3G licensees, on the assumption that the SUF payment as the result of a competitive auctioning exercise would be extremely high. The Authority considered that the 3G market at that time was highly uncertain, both in terms of demand from consumers and availability of services. It was thought that the royalty payment method would allow 3G licensees to spread the payment of SUF over the whole licensing period and thus reduce the upfront financial burden. It was also thought that the guaranteed, minimum royalty payment requirement would minimise credit risks to the Government and reduce the costs that may be passed on to the consumers, and that a royalty payment based on network turnover would allow the Government to share the upside of the future 3G services.

(4) In 2005 and 2006, when the 2G licences were renewed, the 2G licensees were also required to pay SUF on an annual basis fixed at a specified sum per kHz assigned or by reference to turnover (except for the first five years when the SUF was at a specified sum per kHz assigned).

(5) The practice of the Authority to require upfront payment of SUF in a lump sum started in 2007 in relation to the licensing of spectrum in the 850MHz band for the provision of CDMA2000 service. By that time, the Authority considered it unlikely that prospective licensees would bid irrationally such that the SUF would be very high and the bid would subsequently become a heavy financial burden on the successful bidder. The Authority also considered that many of the considerations mentioned in (3) above might no longer be valid or relevant. In particular, the 3G market was much more mature then than what it was 5 years ago. Proven network infrastructure and customer equipment were widely available from major equipment providers in the

world, and full-fledged 3G services had been launched around the world with attractive service features at affordable prices. The industry had already accumulated a wealth of experience in the implementation and operation of 3G networks and in devising business strategies for marketing the services. Thus, the Authority believed that the resultant SUF would be able to reflect more accurately and rationally the true commercial market value in the auction of the spectrum in the 850 MHz band, and the financial burden of the prospective licensee should not be an overriding concern. Also, the Authority considered that the royalty payment method would result in high administrative costs for both the Government and the 3G licensees in implementing accounting separation to ensure that all relevant revenues were included in the calculation of royalties. For those reasons, it was decided to adopt a popular and simpler alternative, namely, a one-off SUF payment such that the bidders simply placed bids through auction on the amount of the one-off payment that they were willing to pay for the use of spectrum. It was considered that such arrangement was simple, quick and easy to administer, and the amount of SUF as determined would equally reflect the market value of the spectrum and safeguard the Government's revenue in SUF.

(6) The same method relating to the fixing and payment of SUF, ie an upfront, lump sum, payment fixed by auction, was adopted in the 4G Auction relating to the assignment of the 4G spectrum in January 2009, and the 2G Auction relating to the assignment of the additional 2G spectrum in June 2009 (in relation to the portion of the SUF to be paid upfront in a lump-sum).

51. It is, I believe, fair to infer on the evidence that the Authority's reasons for using the same method in relation to the fixing and payment of the SUF in the 4G Auction and 2G Auction were also those mentioned in [50(5)] above. Accordingly, I accept as correct the Taxpayer's submission that the change in the method of fixing and payment of SUF from an annual, royalty, basis to an upfront, lump-sum, basis was driven by economic, business and administrative considerations. It does not, however, follow thereby that the SUFs paid by the licensees under the two bases must, as a matter of law, both be regarded as either capital or revenue (ie consistently). As submitted by Mr Fung, SC, correctly in my view, the motive or purpose of the recipient (ie the Authority in this case) in the method of payment is not a relevant consideration in deciding whether the payment is capital or revenue in nature as far as the profits tax position of the payer is concerned. The correct question is what the payment (or expenditure) is calculated to effect from the payer's (not the recipient's) practical and business point of view (*Hallstroms*, *ante*, at 648 *per* Dixon J)[12].

[12] See [69] of CIR's Skeleton Submissions dated 4 September 2019.

52. In any event, the validity of the Taxpayer's argument is dependent on the assumption that the Commissioner's acceptance that the annual SUF payments previously made by the Taxpayer were revenue in nature and deductible is correct as a matter of law. That the Commissioner had previously accepted that the annual SUF payments on royalty basis made by the Taxpayer were revenue in nature and thus deductible is not in dispute[13]. Whether the Commissioner is correct in law to do so is another matter. For the purpose of this appeal, I am prepared to assume (without deciding) in the Taxpayer's favour that the Commissioner's treatment of the annual SUF payments previously made by the Taxpayer is correct in law. Nevertheless, it seems to me that there are significant differences between those payments and the Upfront SUFs paid by the Taxpayer for the assignment of the 4G spectrum and the assignment of the additional 2G spectrum in 2009. In particular, the previous payments were (i) made annually, and (ii) calculated by reference to the network turnover of the Taxpayer subject to a minimum amount (as from the 6th year of the relevant licence). These are relevant factors, or *indicia*, which support the view that those payments are revenue in nature. In so far as the Upfront SUFs are concerned, for the reasons given in [29] above, I am of the view that they were capital in nature.

GROUND 5: THE BOARD HAS FAILED TO GIVE PROPER REGARD TO THE FACT THAT THE IRD HAD ACCEPTED THE ANNUAL SUF PAYMENTS PREVIOUSLY MADE BY THE TAXPAYER AS REVENUE IN NATURE AND DEDUCTIBLE

53. See [49] - [52] above.

GROUND 6: THE "CIRCULATING CAPITAL TEST"

54. In *ABD Ptd Ltd v Comptroller of Income Tax* [2010] 3 SLR 609, at [49], Andrew Phang Boon Leong JA referred to the following observation of Prof Tiley (*Revenue Law*, Hart Publishing, 6th Ed, 2008, at 445) which explained the distinction between fixed and circulating capital:

> "Expenditure on the fixed capital of a business is capital expenditure, not revenue. Fixed capital is retained in the shape of assets which either produce income without further action, eg shares held by an investment company, or are made use of to produce income, eg machinery in factory. Circulating capital is that which the company intends should be used by being temporarily parted with and circulated in the business only to return with, it is hoped, profit, eg money spent on trading stock."

55. In BP Australia, *ante*, at 265-266, Lord Pearce said:

> "Fixed capital is *prima facie* that on which you look to get a return by your trading operations. Circulating capital is that which comes back

[13] See "Hong Kong Third Generation Mobile Services Licensing: Information Memorandum" (July 2001), at [4.9].

> in your trading operations. The sums in question were sums which had to come back penny by penny with every order during the period in order to reimburse and justify the particular outlay."

56. The fixed and circulating capital test has been criticised as being circular ("it sometimes begs the very question in issue", "assume the very thing (*viz*, the distinction between capital and revenue)", "of limited usefulness only", and "there appears to be no real guidance in this particular test"): see *ABD Ptd Ltd*, *ante*, at [50] to [52]. In *Van den Berghs Ltd v Clark (Inspector of Taxes)* [1935] AC 431, Lord Macmillan observed, at 443, as follows:

> "I have not overlooked the criterion afforded by the economists' differentiation between fixed and circulating capital which Lord Haldane invoked in *John Smith & Son v. Moore*[14] and on which the Court of Appeal relied in the present case, but I confess that I have not found it very helpful. Circulating capital is capital which is turned over and in the process of being turned over yields profit or loss. Fixed capital is not involved directly in that process, and remains unaffected by it."

57. In addition to the criticism that the fixed and circulating capital test is essentially circular, another problem with the test, it seems to me, is that it fails to take into account the nature or character of the asset acquired or advantage sought by the outlay of capital by the taxpayer. The test may be more useful when one is concerned with the profits of a trading company which buys and sells goods and makes its profits from the difference between the purchase and sale price. It is, however, less useful when one is concerned with a service company which employs its capital in building up an infrastructure to provide services to its customers in return for fees or charges.

58. On the facts of this case, the Taxpayer paid the Upfront SUFs to acquire the right to use spectrum, or to have the use of spectrum (it does not seem to me to matter much how it is described), in order to provide 4G services or enhance its 2G services to its customers in return for service fees or charges. I do not see how the fixed and circulating capital test assists the Taxpayer in its contention that the Upfront SUFs were revenue, as opposed to capital, in nature. The fact that in the Taxpayer's financial statements, the Upfront SUFs were paid and recouped from the operating receipts of the Taxpayer, a matter relied on by the Taxpayer, seems to me to entirely irrelevant[15]. The financial statements merely recorded how the Taxpayer funded the Upfront SUFs, but cannot answer the question of whether the Upfront SUFs should, as a matter of law, be regarded as capital or revenue in nature.

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[14] [1921] 2 AC 13.

[15] See [84.2] of the Submissions of the Appellant.

GROUND 7: THE OVERSEAS AUTHORITIES

59. It is not with disrespect that I do not propose to analyse the overseas authorities relied upon by the Board (namely, (i) *BFH v The Comptroller of Income Tax* [2013] 4 SLR 568, and (ii) *ITC 1726* (2000) 64 SATC 236, followed in *ITC 1772* (2003) 66 SATC 211) in coming to the conclusion that the Upfront SUFs were capital in nature. The true nature of the payment in any case must of course be looked at in light of the legal context in the relevant jurisdiction and the factual context of that case, and the conclusion reached cannot be directly transposed to the present case. However, having read those decisions, it seems to me that the Singaporean and South African courts were applying the well-established principles referred to in [15] to [18] above for determining whether the payments in question were capital or revenue in nature. The Board's decision in this case is also entirely consistent with those principles. I do not consider that the Board erred in law in relying on those overseas authorities as supporting its conclusion that the Upfront SUFs were capital in nature.

GROUND 8: THE BOARD HAS ERRED IN ITS APPLICATION OF THE INDICIA SUGGESTED IN THE AUTHORITIES IN THAT ITS ANALYSIS WAS PREMISED ON THE INCORRECT NOTION THAT THE UPFRONT SUF IS PAID FOR THE RIGHT TO USE THE SPECTRUM (AS DISTINCT FROM ITS ACTUAL USE)

60. This ground adds nothing to the previous grounds.

DISPOSITION

61. In all, I am not persuaded that the 8 grounds of appeal, considered either separately or cumulatively, demonstrate that the Board's conclusion that the Upfront SUFs were capital in nature is wrong in law. The Taxpayer's appeal is accordingly dismissed, with costs to the Commissioner, to be taxed if not agreed, with certificate for 2 counsel.

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

Mr Ronny Wong, SC, Mr Stewart K M Wong, SC, Mr Vod Chan, Ms Doris Li 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