Case No. D31/17

Profits tax – whether legal expenses incurred by directors and shareholders of the company was deductible – whether the Inland Revenue could depart from the position in its previous statement of loss after a period of 6 years – whether the legal fees were capital in nature - whether the Inland Revenue Department had treated like cases alike in the past is the primary concern – the proper approach to look at the circumstances leading to the payment of the legal fees and the nature of the legal fees – whether the statement of loss is an assessment section 60 of the Inland Revenue Ordinance

Panel: William M F Wong SC (chairman), Shun Yan Edward Fan and Law Chung Ming Lewis.

Date of hearing: 23 January 2018.
Date of decision: 23 March 2018.

The Appellant is a private company incorporated in Hong Kong. The Appellant objects to the Profits Tax Assessments for the years of assessment and the Additional Profits Tax Assessment raised on it. The directors and shareholders of the Appellant were couples and were charged with offences relating to tax fraud (hereinafter referred to as 'the Couple'). The Appellant considers that all the legal expenses incurred by the Couple in the aforesaid legal proceedings, which were settled by the Appellant, should be deducted as expenses of the Appellant. The key issue for this Board to decide is whether the Appellant should be allowed deduction of legal fees, which were incurred in proceedings against its directions in their personal capacities.

The Appellant's first ground of appeal should be related to the question of whether the Inland Revenue Department could depart from the position in its previous statement of loss after a period of 6 years, which departure would result in an increased assessment of profits tax for an assessable year within the last 6 years. Secondly, the legal fees are not capital in nature and the Appellant should have losses in revenue if the Couple were not able to serve as the Appellant's directors because of the criminal proceedings in District Court. Thirdly, It is unfair that (i) a taxpayer could not contend even if he receives treatment different from others in similar cases; and (ii) the Revenue did not disclose whether it has allowed deduction of such kind of legal fees in similar cases.

Held:

1. Expenses incurred for the benefit of a company's shareholders and directors do not necessarily form part of the expenses of that company. This Board appreciates that the Couple has considered their continuous service as the Appellant's directors critical to the Appellant's business, but that would not

per se render the Appellant's support/reimbursement of the Couple's expenses in legal proceedings part of the Appellant's own expenses. For instance, where there is no prior contractual agreement between a company and its directors that the company would finance the latter's medical expenses, a director's medical expenses do not normally qualify as an item of expense for the purpose of tax assessment (Anthony Patrick Fahy (t/a A P Fahy & Co) v Commissioner of Inland Revenue [1992] 1 HKLR 207 followed)

2. In the present case, this Board has heard/seen no evidence of any prior contractual arrangement between the Appellant and the Couple for the Appellant to reimburse the latter's legal expenses. Just take an example in the company law context: if a director is being sued for breaches of director's duties, absent any express agreement to the contrary, a company should not be allowed to spend its resources to finance the relevant director's defence. To allow so would usually be a misuse of the company's resources given the very reason for the lawsuit is that the director has not fulfilled his duties to the company. In the commercial world, members of the society incorporate limited companies for business purposes; they must understood that they cannot equate a limited company to its shareholders/directors, especially when there is a lawsuit against the latter.

3. This Board accepts that the Inland Revenue has to observe the statutory duty of confidentiality; so even if it indeed had past cases of different treatment, the Department cannot provide relevant details of those cases to assist this Board. This Board also reminds itself that the burden of proof in this appeal rests on the Appellant; it is for the Appellant to convince us why a ground of appeal is made out.

4. From the Board's point of view, whether the Inland Revenue Department had treated like cases alike in the past is not our primary concern. When one talks about the importance of 'treating like cases alike' in decision-making, he needs to bear in mind the hierarchy of the decision-making authorities. The fact that the first instance court/tribunal has made the same decision multiple times will not per se affect an appellant court/tribunal's view on whether the decision is right or wrong. The interest of 'treating like cases alike' only comes into play when that level of court/tribunal has make a decision or is bound by the hierarchy to follow a higher-tier decision.

5. This Board is more concerned about the true interpretation of the relevant provision of the Ordinance, which shall be decided by analyzing previous decisions of the courts and this Board and other acceptable aids of interpretation (e.g. the Departmental Interpretation and Practice Notes), and the application of this true interpretation to the facts of a case. It is for the Appellant to justify whether there had been unfair treatment and how it affects the true interpretation of the law and its application to a case. The Appellant has not put forward anything on the latter in this appeal.

6. After careful deliberations, this Board agrees with the Inland Revenue Department's submissions that (a) The Legal Fees could not be regarded as the Appellant's expenses as they were not incurred in the production of the Appellant's chargeable profits; and (b) Further or alternatively, even if the Legal Fees could be regarded as the Appellant's expenses and were incurred in the production of the Appellant's chargeable profits, they could only have been capital in nature, and therefore are not deductible.

7. This Board also agrees with the Inland Revenue Department that its Assessor can effectively revise statements of losses after a period of 6 years by reason of the authorities binding on us, and that the unfairness arguments do not assist the appeal (Wharf Properties Limited v Commissioner of Inland Revenue 4 HKTC 310; Strong & Co., of Romsey Limited v Woodifield [1906] AC 448; Commissioner of Inland Revenue v Chu Fung Chee [2006] 2 HKLRD 718; Allen v Farquharson Brothers & Co. [1932] 17 TC 59; Spofforth and Prince v Golder [1945] 26 TC 310; D128/01, IRBRD, vol 16, 939; Commissioner of Inland Revenue v Cosmotron Manufacturing Co Ltd [1997] HKLRD 1161; Mallalieu v Drummond [1983] STC 665; McKnight v Sheppard [1999] 3 All ER 491; So Kai Tong v Commissioner of Inland Revenue [2004] 2 HKLRD 416; D4/13, (2013-14) IRBRD, vol 28, 190; British Insulated and Helsby Cables Ltd v Atherton [1926] AC 205 and Sun Newspaper Ltd v FCT (1938) 5 ATD 87 followed.)

8. It is not enough for the Appellant to show a connection between the Legal Fees and the Appellant's trade or business. The statutory intention is to give relief for those expenses which go towards the creation of assessable profits, rather than to allow all sorts of expenses with a general connection to a trade, profession or business only. The proper approach is that, as first step, an Assessor shall look at the circumstances leading to the payment of the Legal Fees and the nature of the Legal Fees, in particular the purposes for which they were incurred.

9. The Legal Fees were prima facie not paid for the purpose of the producing the Appellant's profits and should not be deductible (Allen v Farquharson Brothers & Co. [1932] 17 TC 59 and Spofforth and Prince v Golder [1945] 26 TC 310 followed). The burden is on the Appellant to satisfy why they were.

10. As the Appellant is a limited company, it is necessary to look at the conscious thinking of the Appellant's controlling minds, i.e. the Couple, at the time of paying the Legal Fees. The purpose of making a payment should not be ascertained by only the conscious mind of the payer at the time of payment. Even though the Couple or the Appellant might have held a genuine belief in the profit-production nature of the Legal Fees, the purpose of payment was after all an objective question for this Board after looking at all the circumstances of the case; the subjective thinking of the

controlling minds of the Appellant does not conclude the question (Mallalieu v Drummond [1983] STC 665 followed).

11. This Board has no doubt that, at the time the prosecution against the Couples were proceeded with, the reason to defend, and so the purpose of incurring the Legal Fees, were not to generate income or profit. This Board is unable to see any difference between the Legal Fees and the fees paid to professionals in the course of tax appeals or criminal proceedings against a partner of the business partnership. No doubt, the matters in this and those cases arose from an inquiry/investigation into the business affairs of the taxpayer; in fact the criminal proceedings in the present case arose from a field audit of the Appellant's tax records in 2000. While one may argue that the taxpayers' success in these legal proceedings would incidentally bring benefits to the taxpayers, such benefits are not profits or incomes in nature. In the present case, the benefit was just the continuity of the partnership and the Appellant – again not a profit as such (Allen v Farquharson Brothers & Co. [1932] 17 TC 59 and Spofforth and Prince v Golder [1945] 26 TC 310 followed).

12. The similarity of this and those cases is that the subject fees were incurred at a time when the underlying events giving rise to the potential liabilities had already occurred and they were not something of future implication to the business activities of the taxpayers other than the immediate financial impact. This Board is not satisfied that the Legal Fees were spent in the production of profits. The Appellant had not provided any evidence or submission at all to show why the nature of Legal Fees would be similar to the legal costs in McKnight and the compensation for libel claims in Herald & Weekly Times. To say the least, the Appellant had never sought to explain how the issues in the criminal and other related proceedings would recur in its further business pursuits. More fundamentally, the interests of the Appellant and the Couple did not necessarily merge when the Legal Fees were incurred. They had a separate interest – if the tax fraud allegation against the Couple had been upheld, it would have been in the interest of the Appellant to get the wrongdoing rectified and it would not have been in the Appellant's interest to further the defence of the Couple (Allen v Farquharson Brothers & Co. [1932] 17 TC 59; Spofforth and Prince v Golder [1945] 26 TC 310; McKnight v Sheppard [1999] 3 All ER 491; Herald & weekly Times Ltd v Federal Commissioner of Taxation (1932) 48 CLR113; Commissioner of Inland Revenue v Chu Fung Chee [2006] 2 HKLRD 718; and D4/13, (2013-14) IRBRD, vol 28, 190 followed).

13. Even if this Board is wrong and that part of the Legal Fees were indeed expended in the production of the Appellant's profits, it is inconceivable to suggest that the fees incurred for applications for recusal, permanent stay and the subsequent judicial review should be allowed for deduction. Those application /proceedings might be strategically appropriate for the Couple for their conduct of the District Court case, deduction should not be

extended to the part of legal services which were only paid for ancillary purposes. Such expenses were even more remote to production of profits when comparing with the costs of defending the District Court case itself (D4/13, (2013-14) IRBRD, vol 28, 190 followed).

14. Even if the Legal Fees, or a part thereof, could somehow be considered to have been incurred in the production of the Appellant's chargeable profits, the Legal Fees were capital in nature and thus not deductible.

15. A statement of loss is not an assessment, the statutory 6-year time limit governing the issue of additional assessment under section 60 of the Ordinance is not applicable to a statement of loss. In the circumstances, the Assessor was empowered to adjust the Appellant's loss for the years of assessment 2006/07 to 2008/09 for the purpose of the assessments for 2009/10 to 2013/14 even though, at the time he did so, it was beyond a 6-year period from when such losses were reportedly incurred (Commissioner of Inland Revenue v Common Empire Limited [2006] 1 HKLRD 942; and Commissioner of Inland Revenue v Common Empire Limited [2007] 1 HKLRD 679 followed).

Appeal dismissed.

Cases referred to:

British Insulated and Helsby Cables Ltd v Atherton 10 TC 155
Commissioner of Inland Revenue v Swire Pacific Limited [1979] HKLR 612
Anthony Patrick Fahy (t/a A.P. Fahy & Co) v Commissioner of Inland Revenue [1992] 1 HKLR 207
Wharf Properties Limited v Commissioner of Inland Revenue 4 HKTC 310
Strong & Co., of Romsey Limited v Woodifield [1906] AC 448
Commissioner of Inland Revenue v Chu Fung Chee [2006] 2 HKLRD 718
Allen v Farquharson Brothers & Co. [1932] 17 TC 59
Spofforth and Prince v Golder [1945] 26 TC 310
D128/01, IRBRD, vol 16, 939
Commissioner of Inland Revenue v Cosmotron Manufacturing Co Ltd [1997] HKLRD 1161
Mallalieu v Drummond [1983] STC 665
McKnight v Sheppard [1999] 3 All ER 491
So Kai Tong v Commissioner of Inland Revenue [2004] 2 HKLRD 416
D4/13, (2013-14) IRBRD, vol 28, 190
British Insulated and Helsby Cables Ltd v Atherton [1926] AC 205
Sun Newspapers Ltd v FCT (1938) 5 ATD 87
Herald & Weekly Times Ltd v Federal Commissioner of Taxation (1932) 48 CLR 113
Commissioner of Inland Revenue v Swire Pacific Limited [1979] HKLR 612

Commissioner of Inland Revenue v Common Empire Limited [2006] 1 HKLRD 942
Commissioner of Inland Revenue v Common Empire Limited [2007] 1 HKLRD 679

Appellant's Director appeared for the Appellant.
Yu Wai Lim and Lee Shun Shan, for the Commissioner of Inland Revenue.

Decision:

1. This is the appeal of Company A ('the Appellant') against the determination of Deputy Commissioner of Inland Revenue dated 31 August 2017 ('the Determination'). The Appellant objects to the Profits Tax Assessments for the years of assessment 2009/10 to 2012/13 and the Additional Profits Tax Assessment for the year of assessment 2013/14 raised on it.

2. The key issue for this Board to decide is whether the Appellant should be allowed deduction of legal fees, which were incurred in proceedings against its directors in their personal capacities, in the total amount of $10,919,300 for the years of assessment 2006/07 to 2009/10.

Material Facts

3. The following material facts are extracted from the Determination and are not in dispute:

(a) The Appellant is a private company incorporated in Hong Kong in 1983.

(b) Mr B and Ms C (referred to as 'Mr B' and 'Ms C' individually and as 'the Couple' collectively) are husband and wife. During the relevant times, the Couple were directors and shareholders of the Appellant.

(c) In 2006, the Couple were charged with offences relating to tax fraud between 1994 and 2006. They were each issued with 10 summonses and attended at the Eastern Magistracy. Their cases were later transferred to the District Court ('the District Court case'). The Couple applied to the District Court for a permanent stay of the District Court case.

(d) By a judgement in late 2007, the Couple's application for a permanent stay of the criminal proceedings against them was refused.

(e) The Couple applied for leave for judicial review against the above ruling, but the application was rejected by the Court of First Instance.

(f) The Couple then lodged an appeal to the Court of Appeal which was dismissed.

(g) The District Court case was heard between June 2009 to November 2009.

4. The Appellant considers that all the legal expenses incurred by the Couple in the aforesaid legal proceedings, which were settled by the Appellant, should be deducted as expenses of the Company. Mr B, on behalf of the Appellant, held a strong belief and submitted that the Company's business could not have continued without the Couple.

5. Hence, the Appellant furnished its profits tax returns for the years of assessment 2006/07 to 2013/14 together with audited financial statements and tax computations as follows:

(a) In the returns, the Appellant declared the following assessable profits and adjusted losses:

Year of assessment	2006/07	2007/08	2008/09	2009/10
	$	$	$	$
Adjusted Loss	2,856,021	3,090,743	1,674,725	633,387

Year of assessment	2010/11	2011/12	2012/13	2013/14
	$	$	$	$
Assessable Profits	4,265,816	1,571,421	846,219	1,995,968

(b) The adjusted losses for the years of assessment 2006/07 to 2009/10 were arrived at after deducting, among other things, the following legal and professional fees:

Year of assessment	$
2006/07	1,295,187
2007/08	3,005,355
2008/09	2,239,925
2009/10	4,496,455
Total	11,036,922

6. The Assessor, in accordance with the tax returns, issued to the Appellant statements of loss and raised on it a Profits Tax Assessment as follows:

Year of assessment	2006/07	2007/08	2008/09	2009/10
	$	$	$	$
Adjusted Loss	2,856,021	3,088,743[1]	1,674,725	633,387
Tax Payable thereon	-	-	-	-

Statement of loss Year of assessment	2006/07	2007/08	2008/09	2009/10
	$	$	$	$
Loss brought forward	-	2,856,021	5,944,764	7,619,489
Add: Loss for the year	2,856,021	3,088,743	1,674,725	633,387
Loss carried forward	2,856,021	5,944,764	7,619,489	8,252,876

Year of assessment	2010/11	2011/12	2012/13	2013/14
	$	$	$	$
Assessable Profits	4,265,816	1,571,421	846,219	1,995,968
Less: Loss set-off	4,265,816	1,571,421	846,219	1,569,420
Net Assessable Profits	-	-	-	426,548
Tax Payable thereon	-	-	-	60,380

Statement of loss				
Loss brought forward	8,252,876	3,987,060	2,415,639	1,569,420
Less: Loss set-off	4,265,816	1,571,421	846,219	1,569,420
Loss carried forward	3,987,060	2,415,639	1,569,420	-

The Appellant did not show any disagreement to the above statements of loss or object to the Profits Tax Assessment. Hence, the Profits Tax Assessment for the year of assessment 2013/14 became final and conclusive pursuant to section 70 of the Inland Revenue Ordinance ('the Ordinance').

7. On 22 February 2013, an Assessor of the Inland Revenue Department enquired with Messrs Tony Yuen & Company (Appellant's then tax representatives) ('the Former Representatives') on the legal and professional fees stated in the Appellant's audited financial statements of years of assessment 2006/07 to 2009/10. In response to that enquiry, the Appellant, through the Former Representatives, provided a breakdown of legal and professional fees as follows:

[1] After disallowing donation deduction of $2,000.

	Year of assessment	Messrs Louis K.Y. Pau & Co., Solicitors ('KY Pau')	Messrs K. M. Cheung & Co., Solicitors ('KM Cheung')	Sub-total	Others	Total
		$	$	$	$	$
(a)	2006/07	1,230,000	12,000	1,242,000	53,187	1,295,187
(b)	2007/08	2,992,300	-	2,992,300	13,055[2]	3,005,355
(c)	2008/09	1,200,000	1,000,000	2,200,000	39,925[3]	2,239,925
(d)	2009/10	285,000	4,200,000	4,485,000	11,455	4,496,455
	Total	5,707,300	5,212,000	10,919,300	117,622	11,036,922

('the Legal Fees')

8. The Appellant, through the Former Representatives, made the following claims:

(a) Legal and professional fees paid to KY Pau and KM Cheung totalling $10,919,300 (i.e. the Legal Fees) were for legal services in respect of the District Court case.

(b) The Appellant considered that the Couple were key persons of its management team, without whom the Appellant could not continue its business. Therefore, the Legal Fees paid in defending the District Court case should be allowed for deduction in ascertaining the Appellant's assessable profits.

(c) Section 16(1) of the Ordinance provided that outgoings and expenses incurred 'in the production of profits' chargeable to profits tax were allowed for deduction. The term 'in the production of profits' was, in practice, interpreted fairly broadly and it was not usually necessary to show a direct nexus between an expense and the assessable profits in order for an expense to be deductible. Generally, where outgoings or expenses were incurred in the expectation of generating chargeable profits, though no chargeable profits might have been generated, they would still be regarded as having been incurred in the production of chargeable profits.

(d) In British Insulated and Helsby Cables Ltd v Atherton 10 TC 155, Viscount Cave, L C said in page 191:

'*... a sum of money expended, not of necessity and with a view to a*

[2] After excluding an amount of $12,663
[3] After excluding an amount of $5,740

direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purpose of the trade.'

(e) In Commissioner of Inland Revenue v Swire Pacific Limited [1979] HKLR 612, the Court of Appeal held that payments made by a company in order to end the strike of its whole labour force and to continue its business were expenses incurred for the production of chargeable profits.

(f) The Couple were advised by Mr D, who was the ex-representative of the Appellant and an ex-assessor of the Department's prosecution section for many years, that it was the Department's practice to allow deduction of such kind of legal fees.

Legal Principles

First Principle

9. It is very important to understand that, as a matter of first principle, expenses incurred for the benefit of a company's shareholders and directors do not necessarily form part of the expenses of that company.

10. This Board appreciates that the Couple has considered their continuous service as the Appellant's directors critical to the Appellant's business, but that would not *per se* render the Appellant's support/reimbursement of the Couple's expenses in legal proceedings part of the Appellant's own expenses. For instance, where there is no prior contractual agreement between a company and its directors that the company would finance the latter's medical expenses, a director's medical expenses do not normally qualify as an item of expense for the purpose of tax assessment. See: Anthony Patrick Fahy (t/a A P Fahy & Co) v Commissioner of Inland Revenue [1992] 1 HKLR 207.

11. In the present case, this Board has heard/seen no evidence of any prior contractual arrangement between the Appellant and the Couple for the Appellant to reimburse the latter's legal expenses. Just take an example in the company law context: if a director is being sued for breaches of director's duties, absent any express agreement to the contrary, a company should not be allowed to spend its resources to finance the relevant director's defence. To allow so would usually be a misuse of the company's resources given the very reason for the lawsuit is that the director has not fulfilled his duties to the company. In the commercial world, members of the society incorporate limited companies for business purposes; they must understand that they cannot equate a limited company to its shareholders/directors, especially when there is a suit against the latter.

'Treating Like Cases Alike'

12. In the course of the appeal hearing, Mr B appealed to the rule of law and

submitted that like cases should be treated alike. Mr B said he has asked the Inland Revenue Department many times whether there were past cases in which legal expenses incurred by a company's shareholder or director were allowed as deductible expenses of the company for the purpose of the company's tax assessment. The Inland Revenue Department has refused to provide any answer to him, to which he felt aggrieved.

13. During the hearing of this appeal, this Board enquired with Mr Yu of the Inland Revenue Department and was given to understand that the Inland Revenue Department is unable to provide a departmental answer to Mr B's question because of its statutory duty of confidentiality under section 4 of the Ordinance. Mr Yu also said, in his personal experience as an assessor, he had never granted deductions in similar circumstances.

14. This Board accepts that the Inland Revenue Department has to observe the statutory duty of confidentiality; so even if it indeed had past cases of different treatment, the Department cannot provide relevant details of those cases to assist this Board. This Board also reminds itself that the burden of proof in this appeal rests on the Appellant; it is for the Appellant to convince us why a ground of appeal is made out.

15. From the Board's point of view, whether the Inland Revenue Department had treated like cases alike in the past is not our primary concern. When one talks about the importance of 'treating like cases alike' in decision-making, he needs to bear in mind the hierarchy of the decision-making authorities. The fact that the first instance court/tribunal has made the same decision multiple times will not *per se* affect an appellant court/tribunal's view on whether the decision is right or wrong. The interest of 'treating like cases alike' only comes into play when that level of court/tribunal has made a decision or is bound by the hierarchy to follow a higher-tier decision.

16. This Board is more concerned about the true interpretation of the relevant provision of the Ordinance, which shall be decided by analyzing previous decisions of the courts and this Board and other acceptable aids of interpretation (e.g. the Departmental Interpretation and Practice Notes), and the application of this true interpretation to the facts of a case. It is for the Appellant to justify whether there had been unfair treatment and how it affects the true interpretation of the law and its application to a case. The Appellant has not put forward anything on the latter in this appeal.

The Ordinance

17. Both this Board and the Inland Revenue Department have to determine deductible expenses strictly according to the law. The relevant provisions include:

(a) Section 16 of the Ordinance, which provides for deduction of expenses under profits tax as follows:

'*(1) In ascertaining the profits in respect of which a person is chargeable to tax under [profits tax] 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 [profits tax] for any period …'

(b) Section 17 of Ordinance, however, prohibits deduction of certain expenses under profits tax which provides as follows:

'*(1) For the purpose of ascertaining profits in respect of which a person is chargeable to tax under [profits tax] no deduction shall be allowed in respect of –*

…

(a) domestic or private expenses …

(b) … any disbursements or expenses not being money expended for the purpose of producing such profits;

(c) any expenditure of a capital nature or any loss or withdrawal of capital;

… '

The Case Law

18. In Wharf Properties Limited v Commissioner of Inland Revenue 4 HKTC 310, Lord Hoffmann said:

'*Prima facie, therefore, the interest was deductible under section 16(1)(a). It was incurred for the purpose of earning taxable profits in future years: compare* ***Commissioner of Inland Revenue v Swire Pacific Limited*** *[1979] 1 HKTC 1145. But section 17 contains a list of various kinds of expenditure in respect of which "no deduction shall be allowed". Their Lordships think that in the absence of express contrary language, expenditure which comes within section 16 will not be deductible if it falls within one of the prohibited categories in section 17. Since sections 16 and 17 together "provide exhaustively for the deduction side of the account which is to yield the assessable profits" (****Commissioner of Inland Revenue v Mutual Investment Co. Ltd.*** *[1967] 1 AC 587, 598), section 17 would serve no purpose if it did not exclude deductions which would otherwise be allowed under section 16 …*' (at page 389)

19. In Strong & Co., of Romsey Limited v Woodifield [1906] AC 448, a brewing company, which also owned an inn in which they carried on the business of innkeepers, incurred damages and costs against the company for the injury of a visitor staying at the inn by the fall of a chimney. It was held that the damages and costs were not

a loss 'connected with or arising out of the trade' and not 'being money wholly and exclusively laid out' or 'expended for the purpose of the trade'. They were therefore not an expense deductible in computing the company's profits for Income Tax purposes. Lord Loreburn L C said at page 452 the following:

> '*In my opinion, however, it does not follow that if a loss is in any sense connected with the trade, it must always be allowed as a deduction; for it may be only remotely connected with the trade, or it may be connected with something else quite as much as or even more than with the trade. I think only such losses can be deducted as are connected with in the sense that they are really incidental to the trade itself. They cannot be deducted if they are mainly incidental to some other vocation or fall on the trader in some character other than that of trader. The nature of the trade is to be considered ...*'
>
> See also the speech of Lord Davey at page 453:
>
> '*I think that the payment of these damages was not money expended 'for the purpose of the trade.' These words are used in other rules, and appear to me to mean for the purpose of enabling a person to carry on and earn profits in the trade, &c. I think the disbursements permitted are such as are made for that purpose. It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade, or is made out of the profits of the trade. It must be made for the purpose of earning the profits ...*'

These passages from Strong v Woodifield were cited with approval in Commissioner of Inland Revenue v Chu Fung Chee [2006] 2 HKLRD 718 at paragraph 19.

20. In Allen v Farquharson Brothers & Co. [1932] 17 TC 59, the court, applying the principles in Strong v Woodifield, considered that the legal costs of employing solicitors and counsel in connection with an appeal to Income Tax assessments were not expenses for the purpose of earning profits. Hence, it was held that the legal costs were not deductible.

21. In Spofforth and Prince v Golder [1945] 26 TC 310, it was held that legal expenses incurred by a firm of two chartered accountants for the purpose of defending criminal proceedings arising out of acts in the course of its accountants were not expenses incurred for the purpose of producing profits. The facts of that case merit particular attention for the purpose of the present appeal.

22. Mr Spofforth, one of the chartered accountants of the firm, gave tax advice to his client, and helped him set up a company to avoid the payment of surtax. Criminal charges were brought against Mr Spofforth, alleging conspiracy to defraud the Crown. His partner, Mr Prince, was not prosecuted but he instructed separate counsel to hold a watching brief in Mr Spofforth's hearing. In the course of the hearing, Mr Spofforth once wanted to plead guilty upon learning that the Inland Revenue might not press for a serious sentence if he did so. The idea was opposed to by Mr Prince because of the adverse effect this guilty

plea might have on the partnership. Having further considered the opinion from Mr Prince's Leading Counsel, Mr Spofforth gave up that idea and fought the trial. Mr Spofforth was successful in his defence and the firm sought to claim his legal expenses as an allowable deduction. It was held that although (1) the charges arose out of Mr Spofforth's professional activities and (2) it was important to the firm that Mr Spofforth's be defended, the court held, applying Strong v Woodifield, that legal expenses incurred after the issue of summons were not deductible, since they were not for the purpose of earning profits.

23. It is important to note that, even though Mr Spofforth's conduct of the defence of the criminal proceedings was somehow affected by the concern of his partner, the court did not accept that as sufficient for rendering his legal fees deductible expenses. The court even drew reference to the two accountant partners' separate legal representation in the proceedings, and said from that moment the interests of Mr Spofforth were 'thought to be likely to diverge so widely from those of Mr Prince'. The interest of Mr Spofforth was not regarded as the partnership firm's interest.

24. In the course of the appeal, Mr B handed up a note which drew the Board's attention to the fact that the UK statutory provision interpreted in Spofforth was different from section 16(1) of the Ordinance. That UK statutory provision was Rule 3, Schedule D: Cases I and II, which read:

> '*In computing the amount of the profits or gains to be charged, no sum shall be deducted in respect of –*
>
> *(a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment, or vocation; ...*'

25. It was said in the Board's previous decision in 2001 (D128/01), the UK provision and authorities like Strong & Co. op cit were found to be not useful because the core words of the UK provision '*wholly and exclusively laid out or expended for the purposes of the trade*' are considerably narrower than the core words of section 16 '*in the production of profits*' – in other words, the Hong Kong position should be more liberal in accepting deductible expenses. Nevertheless, in 2006, in the decision of Chu Fung Chee (to be cited below), Chung J of the Court of First Instance, following the Privy Council's decision in Commissioner of Inland Revenue v Cosmotron Manufacturing Co Ltd [1997] HKLRD 1161, held that the two strings of words were effectively of the same meaning and should be interpreted in like manner. This Board therefore accepts the line of UK authorities quoted above as highly persuasive.

26. In Mallalieu v Drummond [1983] STC 665, a lady barrister claimed deduction of her expenses on replacements, laundering and cleaning of the clothes she bought in compliance with the Notes for Guidance on Dress in Court approved by the Bar Council, which she should wear during court appearances in computing the profits of her profession. The court, applying the principles in Strong v Woodifield, considered that an expense was deductible only when it was spent for the purpose of enabling a person to carry on and earn profits in the trade. Lord Brightman said at 669c that in order to ascertain

whether the money was expended to serve the purposes of the taxpayer's business, it was necessary to discover the taxpayer's 'object' in making the expenditure. Lord Brightman further said:

> (a) The object of the taxpayer in making the expenditure should be distinguished from the effect of the expenditure:
>
> '*An expenditure may be made exclusively to serve the purposes of the business, but it may have a private advantage. The existence of that private advantage does not necessarily preclude the exclusivity of the business purposes.*' (at 669e)
>
> (b) The taxpayer's conscious motive in mind at the moment of expenditure was not conclusive:
>
> '*... But she needed clothes to travel to work and clothes to wear at work, and I think it is inescapable that one object, though not a conscious motive, was the provision of the clothing that she needed as a human being. I reject the notion that the object of a taxpayer is inevitably limited to the particular conscious motive in mind at the moment of expenditure. Of course the motive of which the taxpayer is conscious is of vital importance, but it is not inevitably the only object which the commissioners are entitled to find to exist. In my opinion, the commissioners were not only entitled to reach the conclusion that the taxpayer's object was both to serve the purposes of her profession and also to serve her personal purposes, but I myself would have found it impossible to reach any other conclusion.*' (at 673b)
>
> It was finally ruled that the taxpayer's expenses were not deductible.

27. In McKnight v Sheppard [1999] 3 All ER 491, it was held that the legal fees of a sole trader stockbroker incurred for the purpose of defending disciplinary proceedings against him were deductible in computing his profits. Though it was argued that the legal fees were paid for dual purposes, one for preservation of his business and the other for preservation of his personal reputation, Lord Hoffmann in that case accepted that the object of the legal fees was expended for the purpose of the trade. He further said at 496d that whether an expense was deductible depended on the nature of the expenditure and the specific policy of rule under which it became payable.

28. It is necessary to note that McKnight is materially different from the above case of Spofforth in one aspect: the legal proceedings in McKnight were against the taxpayer himself whereas the legal proceedings in Spofforth were against a partner/accountant of the taxpayer partnership business. McKnight is also materially different from the case of Chu Fung Chee to be cited below in that the fees of concern in McKnight is the taxpayer's own legal fees, whereas Chu Fung Chee's payment was for the opposite side's costs under a costs order of the proceedings (which was more akin to penalty in nature).

29. In So Kai Tong v Commissioner of Inland Revenue [2004] 2 HKLRD 416, it was held that an objective test should be adopted to decide whether an expense was incurred by a taxpayer in the production of its taxable profits. The objective test required all circumstances to be looked at in deciding whether an item was a deductible expense (at 427D to 427I).

30. In Commissioner of Inland Revenue v Chu Fung Chee [2006] 2 HKLRD 718, the taxpayer was a practising barrister. He claimed deduction of the costs he was ordered to pay to the Hong Kong Bar Council and the Bar Disciplinary Tribunal in respect of disciplinary proceedings brought against him for alleged misconduct while he pursued a study at a university. It was held that the costs were not paid for the purpose of producing profits and were not deductible. The court further considered the following:

(a) The principles in Strong v Woodifield was applicable to Hong Kong. Thus, in order for an expense to be deductible, the degree of connection between the expense and the profit-earning process of the trade, profession or business was important and the tests of being 'really incidental to the trade itself' or having been incurred 'for the purpose of earning the profits' should be satisfied before an expense could be deducted (at paragraphs 19 to 21). The disciplinary proceedings were related to the taxpayer's dealings with a university when he applied for postgraduate studentship which had nothing to do with the taxpayer's practice as a barrister. The test for deductibility was not satisfied simply by saying that the disciplinary proceedings were related to the taxpayer's practice as a barrister and that it could result in the cessation of his practice if the charges were found proven (at paragraphs 22 to 24).

(b) The costs the taxpayer was ordered to pay was only for the purpose of preserving his practice as a barrister and were capital in nature not deductible under section 17(1)(c) of the Ordinance (at paragraph 40).

31. In D4/13, (2013-14) IRBRD, vol 28, 190, the taxpayer was a firm of solicitors. The Solicitors Disciplinary Tribunal and the Law Society of Hong Kong commenced an enquiry into the professional conduct of an equity partner of the taxpayer. The partner made an application to the tribunal for the enquiry to be made in public but the tribunal refused. He then applied for judicial review against the tribunal's ruling. As the partner was unsuccessful before the Court of First Instance and the Court of Appeal, he was ordered to pay the costs of the tribunal. The taxpayer claimed deduction of the costs the partner was ordered to pay in the computation of its assessable profits. The Board decided that the taxpayer should not be allowed deduction of the costs and dismissed the appeal. In coming to the conclusion:

(a) The Board considered that though it might be strategically wise for the partner to apply for judicial review in relation to his defence in the disciplinary proceedings, the taxpayer failed to show how payment of

the costs might be relevant for the purpose of producing its chargeable profits. The Board considered the taxpayer's case was indistinguishable from Chu Fung Chee (at paragraph 23).

(b) The Board accepted that a party to a legal action was entitled, so long as legally permissible, to take whatever course which he considered to be most appropriate in the conduct of the case. Though legal fees of the sole trader stockbroker for the purpose of defending disciplinary proceedings were ruled to be deductible in McKnight v Sheppard, the Board considered that that case did not touch upon whether any expenses incurred for an ancillary proceedings incidental to the main one were deductible. The Board considered that the principle under Strong v Woodifield as approved in Chu Fung Chee did not extend to cover all costs even in the same set of proceedings (at paragraphs 17, 19 & 21).

32. As to the nature of the relevant expenses, in Wharf Properties Limited, P Chan J, considered that in order to decide whether an expenditure was of a capital or revenue nature, it was necessary to examine not only the status of the expenditure but also the reason or purpose for which and the circumstances under which it was incurred:

> '*... These authorities clearly show that not only the status of the payment must be looked at, but also the purpose of the payment, the objective to be achieved by the payment and the circumstances under which it was made. In the case of an interest expenditure, this would include a consideration of the purpose of the loan for which the interest expenditure is incurred ...* ' (at page 348)

33. There is no single decisive test to determine whether a particular item of expenditure is capital in nature or revenue in nature. However, there are various indicia which give guidance as to where the line between capital and revenue is to be drawn (Wharf Properties Limited at page 348). The relevant indicia are as follows:

(a) Whether the expenditure has been made to meet a continuous demand for expenditure as opposed to expenditure made once and for all. Expenditure spent once and for all likely points to capital in nature (Wharf Properties Limited at page 351).

(b) Whether the expenditure on asset/advantage would result in an enduring benefit of business. If the item of expenditure is paid with a view to bringing into existence an asset or an advantage for the enduring benefit of the business, then the expenditure ought to be classified as capital and not revenue in nature (Wharf Properties Limited at page 351), which P Chan J cited British Insulated and Helsby Cables Ltd v Atherton [1926] AC 205 at page 213:

'*But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.*' (Wharf Properties Limited at page 352)

(c) Whether the expenditure relates to the profit-yielding structure, or on the money-earning process (Wharf Properties Limited at page 352). In the Privy Council, Lord Hoffmann put the distinction as follows:

'*the cost of 'creating, acquiring or enlarging the permanent ... structure of which the income is to be the produce or fruit' is of a capital nature, while 'the cost of earning that income itself or performing the income-earning operations' is a revenue expense*' (Wharf Properties Limited at pages 389 to 390)

(d) The Sun Newspaper Limited criteria. In Wharf Properties Limited, P Chan J also cited the well-known passage from the judgment of Dixon J in Sun Newspapers Ltd v FCT (1938) 5 ATD 87:

'*There are, I think, three matters to be considered, (1) the character of the advantage sought, and in this its lasting qualities may play a part, (2) 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 (3) 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.*' (at page 353)

The Appellant's Grounds of Appeal

34. The Appellant's grounds of appeal as contained in its Statement of Grounds of Appeal are summarized as follows:

(a) With reference to paragraph 1(5) of the Determination, the Appellant argued that it was unreasonable to require the Appellant to object to the Appellant's Profits Tax Assessment for the year of assessment 2013/14 when the profits of that year were offset by losses brought forward from previous years.

Here, the Appellant had mistakenly treated the Deputy Commissioner's summary of the case background as part of his reasoning. The Deputy Commissioner was not saying that the Appellant was required to object in 2013/14. To the contrary, he mentioned the background to pave the way for his subsequent explanation that the Assessor was entitled to effectively revise the

statements of losses for years of assessment 2006/07 to 2008/09 after a period of 6 years notwithstanding the provision of section 60 of the Ordinance, so that he could issue notices of Profits Tax Assessment or Additional Profits Tax Assessments for years 2009/10 to 2013/14 on 18 March 2016 and 29 March 2017 respectively.

Properly understood, the Appellant's first ground of appeal should be related to the question of whether the Inland Revenue Department could depart from the position in its previous statement of loss after a period of 6 years, which departure would result in an increased assessment of profits tax for an assessable year within the last 6 years;

(b) The Legal Fees are not capital in nature and the Appellant should have losses in revenue if the Couple were not able to serve as the Appellant's directors because of the criminal proceedings in District Court.

(c) It is unfair that:

(i) a taxpayer could not contend even if he receives treatment different from others in similar cases; and

(ii) the Revenue did not disclose whether it has allowed deduction of such kind of legal fees in similar cases.

35. After careful deliberations, this Board agrees with the Inland Revenue Department's submissions that:

(a) The Legal Fees could not be regarded as the Appellant's expenses as they were not incurred in the production of the Appellant's chargeable profits; and

(b) Further or alternatively, even if the Legal Fees could be regarded as the Appellant's expenses and were incurred in the production of the Appellant's chargeable profits, they could only have been capital in nature, and therefore are not deductible.

36. This Board also agrees with the Inland Revenue Department that its Assessor can effectively revise statements of losses after a period of 6 years by reason of the authorities binding on us, and that the unfairness arguments do not assist the appeal (as we have said under the section 'Legal Principles' above). We will elaborate our reasoning in relation to the non-deductibility of the Legal Fees, their capital nature and the 6-year issue in the following.

Legal Fees – Not Deductible Expenses

37. There is no dispute that the Appellant paid the Legal Fees to KY Pau and

KM Cheung during the years of assessment 2006/07 to 2009/10. The Appellant classified the Legal Fees as its own expenses in its account (i.e. legal & professional fees) for those years of assessment.

38. However, the Couple, instead of the Appellant, were the defendants or applicants in those proceedings. Even though the Couple were the only directors and shareholders of the Appellant at all material times, the Couple and the Appellant have always been separate legal entities. The Legal Fees were in fact expenses of the Couple and not the Appellant.

39. As the Appellant had paid the Legal Fees, it might consider that it had incurred the Legal Fees and should be allowed deduction. However, the mere payment of the Legal Fees would not automatically allow the Appellant any deduction for profits tax purpose. The Legal Fees have to satisfy section 16 of the Ordinance and are not excluded by section 17 before they can be deducted for profits tax.

40. In other words, it is not enough for the Appellant to show a connection between the Legal Fees and the Appellant's trade or business. The statutory intention is to give relief for those expenses which go towards the creation of assessable profits, rather than to allow all sorts of expenses with a general connection to a trade, profession or business only.

41. The proper approach is that, as a first step, an Assessor shall look at the circumstances leading to the payment of the Legal Fees and the nature of the Legal Fees (McKnight & Sheppard and So Kai Tong), in particular the purposes for which they were incurred.

42. The Couple, instead of the Appellant, were charged in the District Court case. The Couple would be subject to fines and imprisonment if they were found guilty of those charges. The Couple engaged the services of KY Pau and KM Cheung to handle the District Court case and launched the related proceedings. It is clear that the Legal Fees were paid for the purpose of saving the Couple from the conviction of the offences charged and the possible consequential punishment. Following Allen and Sporfforth op cit, the Legal Fees were *prima facie* not paid for the purpose of producing the Appellant's profits and should not be deductible. The burden is on the Appellant to satisfy why they were.

43. The Appellant has been trying to emphasize that, as the Couple were important members of the Appellant, it would have dealt a severe blow to the Appellant's trade or business if the Couple were found guilty of those charges or even imprisoned. In our view, the Appellant is trying to argue that the purpose of paying the Legal Fees was for the Appellant's benefit. This purpose, thus argued, was in line with the purpose of producing profits for the Appellant. As the Appellant is a limited company, it is necessary to look at the conscious thinking of the Appellant's controlling minds, i.e. the Couple, at the time of paying the Legal Fees.

44. Applying Mallalieu v Drummond, however, the purpose of making a payment should not be ascertained by only the conscious mind of the payer at the time of

payment. Even though the Couple or the Appellant might have held a genuine belief in the profit-production nature of the Legal Fees, the purpose of payment was after all an objective question for this Board after looking at all the circumstances of the case; the subjective thinking of the controlling minds of the Appellant does not conclude the question.

45. In this connection, this Board has no doubt that, at the time the prosecutions against the Couples were proceeded with, the reason to defend, and so the purpose of incurring the Legal Fees, were not to generate income or profit. This Board is unable to see any difference between the Legal Fees and the fees paid to professionals in the course of tax appeals (Allen) or criminal proceedings against a partner of the business partnership (Spofforth). No doubt, the matters in this and those cases arose from an inquiry /investigation into the business affairs of the taxpayer; in fact the criminal proceedings in the present case arose from a field audit of the Appellant's tax records in 2000. While one may argue that the taxpayers' success in these legal proceedings would incidentally bring benefits to the taxpayers, **such benefits are not profits or incomes in nature**. In Allen, the benefit was a reduction of tax, which by its nature is not a profit (because tax is levied after a profit is ascertained); in Spofforth and the present case, the benefit was just the continuity of the partnership and the Appellant – again not a profit as such.

46. The similarity of this and those cases is that the subject fees were incurred at a time when the underlying events giving rise to the potential liabilities had already occurred and they were not something of future implication to the business activities of the taxpayers other than the immediate financial impact. In Allen, the facts giving rise to tax liability had occurred, and the tax appeal was argued on whether those past facts might attract tax liability or not. In Spofforth and the present case, likewise, the suspicious criminal acts happened before the incurring of fees. There had been no suggestion that these facts/acts would have a likely repetition in the further business activities of the taxpayers. Such similarity explains why the treatment in Allen and Spofforth is different from McKnight and the case of Herald & Weekly Times Ltd v Federal Commissioner of Taxation (1932) 48 CLR 113 (a case cited by Chung J in Chu Fung Chee). In McKnight, the subject of the legal proceedings was the taxpayer himself. If the taxpayer lost the disciplinary proceedings, he would lose his licence to carry on the trade further, which must have an impact on the future generation of profits. In Herald & Weekly Times, compensation paid by a press company in libel claims was tax deductible because the libellous statements were published for the very purpose of boosting sale of newspaper and generation of profits. Being sued for libel is something of a repetitive (or even routine) nature to a press, and the implication of a lawsuit (or the settlement of it) to the press's future business must be material.

47. It should be remembered that, in Chu Fung Chee, the amounts held to be non-deductible were the payment of costs to the opposite side (the prosecutor of the disciplinary proceedings). If the expenditure of concern were the taxpayer's own costs, the outcome and analysis in Chu Fung Chee would be definitely different. This is apparently also the reason why the Inland Revenue Department made a concession as to the taxpayer's own legal fees in disciplinary and ensuing court proceedings in the case of D4/13.

48. Turning back to the present case, while one may have sympathy with the Appellant, given the criminal proceedings arose from a field audit of the Appellant's tax

records a long time ago and the Couple were ultimately acquitted of the charges against them, such sympathy cannot place them in a position different from the taxpayers in Allen and Spofforth. This Board is not satisfied that the Legal Fees were spent in the production of profits. The Appellant had not provided any evidence or submission at all to show why the nature of Legal Fees would be similar to the legal costs in McKnight and the compensation for libel claims in Herald & Weekly Times. To say the least, the Appellant had never sought to explain how the issues in the criminal and other related proceedings would recur in its further business pursuits. More fundamentally, the interests of the Appellant and the Couple did not necessarily merge when the Legal Fees were incurred. They had a separate interest – if the tax fraud allegation against the Couple had been upheld, it would have been in the interest of the Appellant to get the wrongdoing rectified and it would not have been in the Appellant's interest to further the defence of the Couple. This is exactly the situation in Spofforth.

49. For completeness sake, even if this Board is wrong and that part of the Legal Fees were indeed expended in the production of the Appellant's profits, it is inconceivable to suggest that the fees incurred for applications for recusal, permanent stay and the subsequent judicial review should be allowed for deduction. Those application/proceedings might be strategically appropriate for the Couple for their conduct of the District Court case, but like the challenge against holding disciplinary proceedings 'in camera' in the case of D4/13, deduction should not be extended to the part of legal services which were only paid for ancillary purposes. Such expenses were even more remote to production of profits when comparing with the costs of defending the District Court case itself.

Legal Fees - Capital in Nature

50. Even if the Legal Fees, or a part thereof, could somehow be considered to have been incurred in the production of the Appellant's chargeable profits, the Legal Fees were capital in nature and thus not deductible.

(a) The Legal Fees were incurred to obtain an advantage for the enduring benefit of the Appellant's trade or business. If the Appellant had not paid the Legal Fees, the Couple might have suffered from imprisonment or even disqualification from being acting as directors further. On the basis of the Appellant's own assertion that the Couple were instrumental to the business of the Appellant, the Legal Fees were paid for the purpose of protecting the Appellant's asset or capital investment in human resources.

(b) The Legal Fees were spent on the profit-yielding structure of the Appellant's trade or business, rather than on its income-earning process. The Legal Fees were certainly not used to generate any specific or identifiable item of income.

(c) The Legal Fees were incurred once and for all for the Couple's District Court case and other related legal proceedings. Though the Appellant paid the Legal Fees during the years of assessment 2006/07

> to 2009/10, it is not the frequency of payment but the purpose and the circumstances under which an expense was paid which determines whether an expense is a capital or a revenue expenditure. In Wharf Properties Limited, the taxpayer borrowed short-term loans from different banks and financial institutions to finance its acquisition of an asset and claimed deduction of interest payments. As it was held that the loans were used to finance an asset which was capital in nature, the periodic or annual interest payments for those short-term loans, were held to be capital in nature and not deductible.

51. On this ground, the Appellant referred to a Consent Summons of a High Court action between the Appellant and another company against a staff member of the Appellant, who was said to be accused of misconduct. This Board does not understand their relevance to the present appeal, and Mr B also made no explanation in relation to that during the hearing.

52. The Appellant also tries to rely on Commissioner of Inland Revenue v Swire Pacific Limited [1979] HKLR 612 to support its position. However, this Board does not consider that case helpful to the Appellant's position. In Swire Pacific Limited, it was ruled that a payment which was incurred to bring a strike to an end was deductible. That payment was not capital as it did not bring any asset to the taxpayer or preserve any, but it enabled the business of the taxpayer to carry on. On proper analysis, the payment in that case was only to discharge an existing contingent liability of the taxpayer, and the nature of the liability might not be once and for all – there could be future labour union actions in future. The Legal Fees in the Appellant's case was clearly not of the same type: first it was not an existing liability of the Appellant (as opposed to the Couple) at the time they were paid; second, no one had ever suggested that the criminal prosecutions against the Couple or other personnel of the Appellant would become a matter of recurrence.

Departure from Previous Statements of Losses

53. Section 60 of the Ordinance governs the issue of additional assessment which provides as follows:

> ' *(1) Where it appears to an assessor that for any year of assessment any person chargeable with tax has not been assessed or has been assessed at less than the proper amount, the assessor may, within the year of assessment or within 6 years after the expiration thereof, assess such person at the amount or additional amount at which according to his judgment such person sought to have been assessed ...*'

54. In the present case, the loss statements for the years of assessment 2006/07 to 2012/13 were originally issued in accordance with the profits tax returns and tax computations furnished by the Appellant (except that a donation of $2,000 was disallowed for the year of assessment 2007/08). The Profits Tax Assessment for the year of assessment 2013/14 was issued in accordance with profits reported by the Appellant in its profits tax

return and tax computation minus the loss brought forward from the years prior to the year of assessment 2013/14 (after a minor adjustment in respect of the said donation). The Inland Revenue Department subsequently revised the assessments of profits for years from 2009/10 to 2013/14 on 18 March 2016 and 29 March 2017 respectively.

55. The argument that the Inland Revenue Department was entitled to adjust the losses for the years of assessment from 2006/07 to 2008/09 more than 6 years after the respective loss years, by way of a review of the assessments of the subsequent years 2009/10 to 2013/14, has caused this Board some concern.

56. On one view, the tax positions of 2006/07 to 2008/09 should be regarded as concluded as at 2016 or 2017. The losses in those years, which represented the concluded tax positions for those years, had been brought forward. An ordinary taxpayer would have assumed that such concluded losses brought forward, as featured in the assessments for 2009/10 to 2013/14, would have also been concluded. This Board thus found the Appellant's grievance over this ground understandable. However, we are bound by a case authority to rule in favour of the Inland Revenue Department on this point.

57. In Commissioner of Inland Revenue v Common Empire Limited [2006] 1 HKLRD 942, the Court of First Instance ruled that a statement of loss was not an assessment within the meaning of the Ordinance but was issued for administrative convenience. Deputy High Court Judge To said:

> '*... the only reasonable meaning which could be given to the word "assessment" for the purpose of s. 59 and likewise ss. 60 and 62 is that it is a process of ascertaining or computing ... the assessable profits of a person subject to profits tax and the application of the appropriate rate of tax to that amount assessed to yield a positive amount of tax chargeable against the person assessed to tax. An ascertainment of loss which does not result in the application of the appropriate rate of tax to that loss is not an assessment within the meaning of the Ordinance ...*' (at paragraph 39)
>
> '*Thus an assessment is to be distinguished from a mere computation of loss. The computation of loss may be a step towards making an assessment but no assessment would be made in respect of a loss in the year of assessment in which it was incurred except where it is available for set-off against the other profits or income of the taxpayer in that year when the loss would be brought into the assessment not as a loss per se but as part of the ascertainment of the taxpayer's assessable profits for that year.*' (at paragraph 41)

58. In the Court of Appeal ([2007] 1 HKLRD 679), Hon Rogers VP endorsed the view of the Court of First Instance that a statement of loss was not an assessment and further ruled that a statement of loss was simply an administrative document which had no statutory force and said:

> '*8. … I reach the conclusion that an assessment is a process by which an assessor, and in some circumstances an Assistant Commissioner, determines the amount of tax payable by a person. If there is no tax payable by a particular person, the assessor does not assess that person.*
>
> *9. In contrast, there is no statutory reference to a "statement of loss". A statement of loss is simply an administrative document which has no statutory force …*'.

59. As it is ruled in Common Empire that a statement of loss is not an assessment, the statutory 6-year time limit governing the issue of additional assessment under section 60 of the Ordinance is not applicable to a statement of loss. In the circumstances, the Assessor was empowered to adjust the Appellant's loss for the years of assessment 2006/07 to 2008/09 for the purpose of the assessments for 2009/10 to 2013/14 even though, at the time he did so, it was beyond a 6-year period from when such losses were reportedly incurred.

Disposition

60. For all the reasons stated above, the present appeal is dismissed. This Board is of the view that the Appellant does not have a strong case on the legal merit of this appeal, but it has endured an unusually lengthy process as the Inland Revenue Department sought to reverse its view on the deductibility of the Legal Fees. This Board considers that the proper costs order is no order as to costs.

61. Finally, it remains for this Board to thank Mr B of the Appellant and Mr Yu of the Inland Revenue Department for their helpful assistance.