Case No. D4/18

Profits tax – allowance – sum paid to secure a lease on a shop which was sublet – whether the sum paid capital in nature – section 17(1)(c) of the Inland Revenue Ordinance ('IRO')

Panel: Cissy K S Lam (chairman), Shun Yan Edward Fan and Wong Wai Yee Pauline.

Date of hearing: 16 March 2018.
Date of decision: 24 April 2018.

The Appellant entered into an agreement with the existing tenant of a shop, under which it agreed to pay the existing tenant a sum X in instalments, in exchange for the early termination of the lease between the existing tenant and the landlord, and for the landlord agreeing to enter into a new lease with the Appellant. The landlord subsequently entered into a 2-year lease with the Appellant, with the option for the Appellant to renew the lease for 3 2-year terms. The Appellant sublet the shop to a sub-tenant for a term of 6 years, with an option for the sub-tenant to renew for another 2 years. The Appellant claimed deducted instalments of sum X against the assessable profits for the 2008/09 to 2014/15 years of assessment. It stated in its financial statements that it engaged in the business of property subletting. The assessor raised Additional Profits Tax Assessment by disallowing the deduction of sum X against the assessable profits, as it was considered to be capital in nature. The assessment was confirmed by the Deputy Commissioner. The Appellant appealed against the assessments, arguing that sum X was of revenue nature. After the hearing before the Board, the Appellant's legal representatives submitted 3 further sets of submissions, arguing for the first time that the sublease entered into by the Appellant was in the nature of an assignment.

Held:

1. Sum X was capital in nature. It was a once and for all payment which enabled the Appellant to enter into the lease with the landlord, despite payable by instalments. The lease generated rental income without further action. It was not an asset which the Appellant had to circulate repeatedly in order to earn an income. Sum X was in effect a lease premium, which enabled the Appellant to expand its business into property subletting (Canton Industries Limited v CIR [2008] 3 HKLRD 558, (2008) 7 HKTC 903; Strick v Regent Oil Co Ltd [1966] AC 295; D26/06, (2006-07) IRBRD, vol 21, 521 applied). Sum X was not simply compensation paid by a tenant to a landlord for premature termination of a lease, which may be revenue in nature (D170/98, IRBRD, vol 14, 31 considered).

2. The Appellant should not be permitted to argue that the sublease it entered

was in effect an assignment, as this was a new ground not contained in its grounds of appeal, and no amendment to the grounds was sought (China Map Limited v CIR (2008) 11 HKCFAR 486 followed).

3. Even if the Appellant's new ground was considered, it did not affect the nature of sum X. An option under the lease remained an option unless and until it was exercised. As at the time the sublease was entered into, the Appellant had yet to exercise its option under the lease. Therefore, the sublease could not have been an assignment, because the term of the sublease was longer than the lease (Megarry, The Law of Real Property, 2012 ed, paragraphs 17-142 and 17-143 considered).

4. In addition, the sublease prohibited the sub-tenant to further sublet the shop, and hence it contained more onerous covenants than the lease. This may also mean that the sublease could not have been an assignment. When the subtenant sought to terminate the sublease early, it surrendered the lease back to the Appellant. This clearly showed that the sublease was not an assignment.

5. In any event, it does not matter whether the sublease was an assignment. By sum X, the Appellant acquired the right to enter into the lease, and this enabled it to earn a new source of income. Whether the rental income was earned by means of a subletting or an assignment in law is irrelevant.

Appeal dismissed and costs order in the amount of $20,000 imposed.

Cases referred to:

Canton Industries Limited v Commissioner of Inland Revenue [2008] 3 HKLRD 558, (2008) 7 HKTC 903
Strick v Regent Oil Co Ltd [1966] AC 295
D26/06, (2006-07) IRBRD, vol 21, 521
Chinachem Investment Co Ltd v Commissioner of Inland Revenue [1987] 2 HKTC 261
China Map Limited v Commissioner of Inland Revenue (2008) 11 HKCFAR 486
Megarry, The Law of Real Property, 2012 ed.
Barrett and Others v Morgan [2000] UKHL 1; [2000] 2 AC 264; [2000] 1 All ER 481; [2000] 2 WLR 285
D170/98, IRBRD, vol 14, 31
Commissioner of Inland Revenue v Church Commissioners (1976) 50 TC 516
Commissioner of Inland Revenue v Land Securities Investment Trust (1969) 45TC 495
Bluesparkle Ltd v Revenue & Customs [2012] UKFTT 45 (TC) (12 January 2012)

James Tze, Counsel, instructed by Messrs Gary Lau & Partners, for the Appellant.

Wilson Leung, Counsel, instructed by Department of Justice, for the Commissioner of Inland Revenue.

Decision:

1. The Appellant objected to the Profits Tax Assessments for the years of assessment 2008/09 and 2010/11 and Additional Profits Tax Assessments for the years of assessment 2009/10 and 2011/12 to 2014/15 (see paragraphs 33-34 below). The Appellant claims that 'the Sum' it paid to obtain a lease agreement in respect of a property (see paragraph 11(1) below) should be deductible for profits tax purposes.

2. By Determination dated 16 August 2017 ('the Determination'), the Deputy Commissioner of Inland Revenue ('the Commissioner') confirmed the Assessor's assessments.

3. By Notice of Appeal dated 15 September 2017, the Appellant appealed against the Determination. The sole issue before us is whether the Sum was a capital expenditure or a revenue expenditure. By virtue of 17(1)(c) of the Inland Revenue Ordinance, Chapter 112 ('IRO'), a capital expenditure is not deductible. For reasons set out below, we find that it was a capital expenditure and that the appeal shall be dismissed.

The evidence

4. Mr A, Position B of the Appellant, gave evidence on its behalf. We find him an honest witness trying to state the facts as best he could. But if and insofar as there were inconsistencies between his evidence and the documents, we prefer the documents.

The Facts

5. Much of the facts stated in the Determination are not disputed. On the basis of those facts and the documents and evidence before us, we find the facts stated in paragraphs 7 to 34 below as true and correct.

6. Unless otherwise stated, references to Appendices herein are references to Appendices to the Determination.

7. The Appellant was incorporated as a private company in Hong Kong in 1985.

8. At all relevant times, the Appellant described its principal business activities as provision of agency and consultancy services on properties and properties for sub-letting (see paragraphs 25-27 below).

9. The Appellant closed its annual accounts on 31 March of each year.

10. On 29 April 2008, the Appellant entered into a conditional lease agreement in Chinese ('the Conditional Lease') with Company C by which the Appellant agreed to sublet to Company C the Shop[1] if the Appellant could obtain a lease in respect of the Shop from the landlord, namely, Company E ('the Landlord').

11. On 5 May 2008, the Appellant and Company F, tenant of the Shop at the time, entered into an agreement in Chinese ('the Company F Agreement') by which Company F agreed to early terminate the lease in respect of the Shop on, *inter alia*, the following terms:

(1) In consideration for Company F's agreement to enter into an agreement with the Landlord before 9 May 2008 to terminate the lease and deliver vacant possession of the Shop to the Landlord on or before 30 May 2008, the Appellant would pay Company F $30 million ('the Sum') in the following manner:

	Date of payment	$
(i)	Upon signing of the Company F Agreement	4,500,000
(ii)	Upon signing an early termination agreement with the Landlord	4,500,000
(iii)	Upon delivery of the Shop in vacant possession to the Landlord	6,000,000
(iv)	Remaining by 60 monthly instalments of $250,000 each payable on the first day of each month starting from 1 June 2008	15,000,000
	Total:	30,000,000

(2) The Company F Agreement would be effective on condition that the Landlord would let the Shop to the Appellant immediately after terminating the lease with Company F.

12. By a letter in Chinese dated 5 May 2008, Company F offered and the Landlord accepted that the lease in respect of the Shop would be terminated on 30 May 2008 on condition that:

(1) the Landlord would let the Shop to the Appellant; and

(2) upon Company F's delivery of vacant possession of the Shop to the Landlord on 30 May 2008, both parties' rights and obligations under the lease of the Shop would be cancelled.

13. By a Tenancy Agreement dated 23 May 2008 ('the Head Lease'), the Landlord agreed to let the Shop to the Appellant for a term of two years from 1 June 2008 to 31 May 2010 with an option to renew the lease for three further terms of two years each.

[1] Namely, the premises known as the Front Shop at Address D

14. By clause 3(d) thereof, the Appellant had the right to assign or sublet part or whole of the Shop.

15. By a Sub-Tenancy Agreement dated 31 May 2008 ('the Company G Sub-Lease'), the Appellant agreed to sublet the Shop to Company G, a group company of Company C, for a term of six years from 1 June 2008 to 31 May 2014 with an option to renew for one term of two years.

16. Unlike the Head Lease, Company G agreed with and undertook to the Appellant that it would not assign underlet or otherwise part with possession of the Shop or any part thereof (Clause 5.02).

17. By letters dated 23 July 2008 and 12 August 2008, the Appellant informed the Landlord that it would exercise the option of renewal under the Head Lease to extend the term of the lease for two further terms of two years to 31 May 2014.

18. By a Supplemental Sub-Tenancy Agreement dated 1 December 2008, the Appellant agreed to reduce the monthly rent of the Shop under the Company G Sub-Lease.

19. By a Surrender Agreement dated 21 January 2010 ('the Surrender Agreement'), Company G agreed to surrender the Shop to the Appellant on 31 May 2010.

20. By a Tenancy Agreement dated 15 April 2010 ('the 2010 Company H Sub-Lease'), the Appellant agreed to sublet the Shop to Company H for a term of four years from 1 June 2010 to 31 May 2014 with an option to renew for one term of two years.

21. By another Tenancy Agreement dated 21 May 2014 ('the 2014 Company H Sub-Lease'), the Appellant agreed to sublet the Shop to Company H for a term of 2 years from 1 June 2014 to 31 May 2016.

22. Similar covenants against assignment and underletting could be found in the 2010 and 2014 Company H Sub-Leases.

23. The Appellant had no connection or association with the Landlord, Company F or Company G.

24. The Appellant submitted its profits tax returns for the years of assessment 2008/09 to 2014/15 together with the audited financial statements for the years ended 31 March 2009 to 2015 and profits tax computations.

25. In the Appellant's Reports and Financial Statements for the year ending 31 March 2008 (i.e. the one which pre-dated the Conditional Lease), the Appellant described its principal activities as follows: 'The principal activities of the company have not changed during the year and consisted of the provision of agency and consultancy services on properties.'

26. In the Appellant's Reports and Financial Statements for the following year, i.e. the year ending 31 March 2009, which covered the Conditional Lease, the Company F Agreement, the Head Lease and the Company G Sublease, the Appellant described its principal activities as follows: 'The principal activities of the company have expanded during the year and consisted of the provision of agency and consultancy services on properties and properties sub-letting.' (emphasis supplied)

27. In the Appellant's Reports and Financial Statements for the following year, i.e. the year ending 31 March 2010, the Appellant described its principal activities as follows: 'The principal activities of the company have not changed during the year and consisted of the provision of agency and consultancy services on properties and properties sub-letting.' (emphasis supplied)

28. The same or similar description can be found in the Reports and Financial Statements for the years to follow, namely years ending 31 March 2011 to 2015.

29. This description of the Appellant's principal business activity was repeated in the corresponding tax returns for the relevant years of assessment.

30. In its profits tax returns, the Appellant reported the following assessable profits or adjusted loss, which was arrived at after deducting, *inter alia*, a portion of the Sum as lease premium as follows:

Year of assessment	Assessable profits / (adjusted loss)	The Sum
	$	$
2008/09	(3,034,591)[2]	4,583,333
2009/10	4,012,749	5,000,000
2010/11	829,169	5,000,000
2011/12	3,503,825	5,000,000
2012/13	2,401,936	5,000,000
2013/14	4,729,804	5,000,000
2014/15	6,995,710	416,667

31. The Appellant's detailed income statements for the years ending 31 March 2009 to 2015 showed, *inter alia*, the following particulars:

Year of assessment	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
For the year ended	31-03-2009	31-03-2010	31-03-2011	31-03-2012	31-03-2013	31-03-2014	31-03-2015
	$	$	$	$	$	$	$
Agency & consultancy fee	6,266,205	8,049,266	16,197,677	12,527,044	11,584,807	16,063,055	15,125,247
Subletting rental income	9,800,000	17,350,000	11,900,000	15,600,000	17,160,000	17,472,000	23,270,000
Less:							
Rental expenses	(7,320,000)	(10,170,000)	(11,700,000)	(12,000,000)	(13,000,000)	(13,200,000)	(19,750,000)
Portion of the Sum	(4,583,333)	(5,000,000)	(5,000,000)	(5,000,000)	(5,000,000)	(5,000,000)	(416,667)
Profit/(loss) from subletting	(2,103,333)	2,180,000	(4,800,000)	(1,400,000)	(840,000)	(728,000)	3,103,333
Other income	4,505	25	113,034	3,406	181,526	10,042	19,531

[2] As adjusted loss was computed for the year of assessment 2008/09, the Appellant added back charitable donations of $136,000 in the tax computation.

Year of assessment	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
For the year ended	31-03-2009	31-03-2010	31-03-2011	31-03-2012	31-03-2013	31-03-2014	31-03-2015
	$	$	$	$	$	$	$
Total income (net)	4,167,377	10,229,291	11,510,711	11,130,450	10,926,333	15,345,097	18,248,111
Less: Operating expenses	(7,136,162)	(6,308,581)	(10,032,643)	(7,931,408)	(8,834,161)	(10,946,759)	(11,194,295)
Profit/(loss) for the year	(2,968,785)	3,920,710	1,478,068	3,199,042	2,092,172	4,398,338	7,053,816

32. Based on the tax returns filed, the Assessor issued to the Appellant the following statement of loss and Profits Tax Assessments:

(a) Statement of loss for the year of assessment 2008/09

	$
Reported loss	(3,034,591)
Loss brought forward	-
Loss carried forward	(3,034,591)

(b) Profit Tax Assessments for the years of assessment 2009/10, 2011/12 to 2014/15

Year of assessment	2009/10	2011/12	2012/13	2013/14	2014/15
	$	$	$	$	$
Assessable profits	4,012,749	3,503,825	2,401,936	4,729,804	6,995,710
Less: Loss brought forward	(3,034,591)				
Net assessable profits	978,158				
Tax payable thereon (after Tax reduction)	161,396	566,131	386,319	770,417	1,134,292

33. The Assessor made enquiries with the Appellant of the Sum. After correspondence with the Appellant's then auditor and tax representative, the Assessor was of the view that the Sum was capital in nature and was not deductible. He raised on the Appellant Profits Tax Assessments/Additional Profits Tax Assessments for the years of assessment 2008/09 to 2014/15 to disallow the Sum as follows:

(a) Profit Tax Assessments for the years of assessment 2008/09 & 2010/11

Year of assessment	2008/09	2010/11
	$	$
Returned profits/(loss)	(3,034,591)	829,169
Add: Portion of the Sum	4,583,333	5,000,000
Assessable profits	1,548,742	5,829,169
Tax payable thereon (after tax reduction)	255,542	961,812

(b) Additional Profits Tax Assessments for the year of assessment 2009/10, 2011/12 to 2014/15

34. The Appellant objected to these assessments. The Assessor maintained the

view that the Sum was capital in nature and was not deductible. She maintained the above assessments except that she revised the Profits Tax Assessment for the year of assessment 2008/09 to take into account charitable donations made by the Appellant:

Year of assessment	2009/10	2011/12	2012/13	2013/14	2014/15
	$	$	$	$	$
Returned profits	4,012,749	3,503,825	2,401,936	4,729,804	6,995,710
Add: Portion of the sum	5,000,000	5,000,000	5,000,000	5,000,000	416,667
Assessable profits	9,012,749	8,503,825	7,401,936	9,729,804	7,412,377
Less:					
Profit already assessed	(978,158)	(3,503,825)	(2,401,936)	(4,729,804)	(6,995,710)
Additional assessable profits	8,034,591	5,000,000	5,000,000	5,000,000	416,667
Tax payable thereon	1,325,707	825,000	825,000	825,000	68,750

	$
Returned profits/(loss)	(3,034,591)
Add: Portion of the Sum	4,583,333
	1,548,742
Less: Charitable donations not claimed because of returned loss	(136,000)
Assessable profits	1,412,742
Tax payable thereon (after tax reduction)	233,102

35. The aforesaid revised Profit Tax Assessment for the year of assessment 2008/09, the Profit Tax Assessment for the year of assessment 2010/11 and the Additional Profit Tax Assessments for the years of assessment 2009/10, 2011/12, 2012/13, 2013/14 and 2014/15 were confirmed by the Commissioner in his Determination.

Relevant Statutory Provisions

36. Section 16(1) of the IRO provides that '*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 …*'

37. By section 17(1)(c) of the IRO, '*for the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of any expenditure of a capital nature or any loss or withdrawal of capital.*'

Authorities

38. We were referred to numerous cases by Counsel. While they all throw light on the issue, we feel that we only need to refer to the following cases:

(1) Canton Industries Limited v CIR [2008] 3 HKLRD 558, (2008) 7 HKTC 903, Reyes J;

(2) Strick v Regent Oil Co Ltd [1966] AC 295, HL;

(3) D26/06, (2006-07) IRBRD, vol 21, 521

39. Reyes J in Canton Industries Limited set out succinctly the various tests employed to distinguish between a capital expenditure and a revenue expenditure. With deference, we borrow the words of the learned judge:

'*Tests for revenue or capital*

16. It is not always easy to decide whether an expense is of a capital or revenue nature. One first considers the salient features of an expense. Then, applying commonsense, one assesses whether the sum total of features tip the balance towards one or other nature. See BP Australia Ltd. v. Commissioner of Taxation [1966] AC 224 (PC), at 264E-265B. There can be grey areas where the correct characterisation will have to depend on "degree and comparison".

17. A number of tests are often resorted to as general guides.

18. One test is the "enduring benefit" test. This considers whether an expenditure has been incurred to bring into existence an asset for the enduring benefit of a trade. An expenditure falling within such category is likely to be of a capital nature. See, for example, British Insulated and Helsby Cables Ltd. v. Atherton [1926] AC 205 (HL), at 213-4 (Viscount Cave LC).

19. A similar test is the "once and for all expenditure" test. This posits that a capital expenditure is typically something spent once and for all, while a revenue expenditure is typically something that recurs annually. See, for example, Vallambrosa Rubber Company Limited v. Farmer (1910) 5 TC 529 (Court of Session), at 536 (Lord Cullen).

20. Another test is the "fixed or circulating capital" test. This examines whether an expense is incurred in connection with fixed or circulating capital. Fixed capital consists of assets which, having been acquired, generate income for a business without further action. In contrast, circulating capital relates to things sold, traded or otherwise circulated over and over again during the conduct of a business so as to generate profit for a person. Expenses relating to fixed capital are usually treated as capital in nature. Expenses relating to circulating capital are usually treated as revenue in nature. See, for example, Ammonia Soda Company v. Chamberlain [1918] 1 Ch D 286 (cited by the Board at Decision §15).

> *21. Still another test is the "profit-yielding structure" test. That distinguishes between expenditure to set up, replace or enlarge a business structure for the purpose of generating profit and regular outlays to maintain a process which brings in regular returns to an organisation. The former expenditure is likely to be capital in nature, the latter revenue. See, for example, Sun Newspapers Ltd. and Associated Newspaper Ltd. v. Federal Commissioner of Taxation (1938) 61 CLR 337 (HCA), at 359 (Dixon J).*
>
> *22. The tests are not necessarily conclusive.*' (emphasis supplied)

40. In Strick v Regent Oil, the taxpayer petrol company paid a lump sum to each of the garage owners in return for an agreement by which the taxpayer company took a lease of the garage from the garage owner and then sublet the garage back to the garage owner for the same period less three days, with a 'tie' so that the garage owner was bound to obtain his supply of petrol from the taxpayer company. The lump sum was held by the House of Lords to be a capital expenditure. It was argued by the taxpayer company that the objective underlying the transactions was to secure the tie with the garage owners and thus was part of its marketing costs. The House of Lords dismissed this argument. Whatever was the underlying motive, in choosing to effect the tie in the form of a lease and sublease, the taxpayer company obtained an interest in land which was a capital asset and the cost thereof was a capital expenditure.

41. Lord Upjohn at pages 341-342:

> '*..., in the field of real property in relation to taxation certain matters are so fundamental as now to be axiomatic. Thus in cases other than those where a man is a property dealer so that property is his stock-in-trade it is quite clear that the purchase of a fee simple for a purchase price by a trader is the acquisition of property for the purposes of trade and the purchase cannot be regarded as a cost of carrying on the trade, it is therefore capital. This is so though the trader may desire to acquire the property for the purpose of providing himself with circulating capital by mining operations on the property acquired even if he is intending to acquire the property only for a short time: see Knight v. Calder Grove Estates. Exactly the same principle applies if the purchase price is payable by instalments spread over a period; it is a capital payment. But if the trader acquires a property on lease and pays a rent reserved by that lease that rent is not regarded as merely the acquisition of property de die in diem*[3]*, but as payment for the use of property and the rent therefore is treated as a revenue expenditure and is deductible for purposes of tax. ... ... But it frequently happens that the trader, anxious to acquire a leasehold property, has to pay a premium for the acquisition of a lease or possibly on renewal of a lease on its expiry; there can be no difference between the two situations. In such a case it is*

[3] de die in diem = from day to day

> *quite clear that the payment of a premium is regarded as the cost of acquiring the property for the purposes of the trade and not as part of the carrying on of the trade, and hence the premium although paid for a property of a wasting character is capital. ... There is no magic in the use of the word 'premium'; it merely means a lump sum paid as a consideration for the acquisition of the lease. And so also, if the premium or lump sum is paid by instalments spread over the term of the lease it still remains of a capital nature. ... ...*'(emphasis supplied)

42. In addition, we refer to Sir Alan Huggins, VP in Chinachem Investment Co Ltd v CIR [1987] 2 HKTC 261at page 308:

> '*It is accepted by the Commissioner that the accounts are not conclusive evidence of the matter in issue, and obviously that is rightly accepted. Nevertheless the accounts must remain important and call for credible explanation, because they are contemporaneous evidence of the Company's intention. Yet no other member of its staff – not even the accountant – was called to explain how the "mistake" came to be made. ... I agree with the judge that "the way in which the properties have been treated in the accounts is by no means an insignificant factor" ...*'

43. We think the fact that the Appellant have taken great care in setting out in its Reports and Financial Statements and tax returns the expansion and maintenance of the Appellant's business to one of property subletting is significant. The Appellant did not claim to be a property dealer.

Our Decision

44. At the Hearing, Mr Tze for the Appellant, no doubt attracted by the dictum of Lord Upjohn in Strick v Regent Oil above, argued that the Appellant was a property dealer and elicited evidence from Mr A to the effect that the Shop was acquired for resale. On the other hand, he did not seek to argue that the Company G Sub-Lease was an assignment. Indeed he accepted that there was no assignment. This Board was left confused with Mr Tze's position and at the end of the hearing, asked parties if authorities could be found on the effect of a subletting, whether a subletting could be a 'sale' of interest.

45. Following that, Mr Leung, Counsel for the Commissioner, filed one further written submission on 19 March 2018. Mr Tze, on the other hand, filed 3 further written submissions into the Board, raising a number of new arguments. We take a dim view of this practice, especially when a number of his arguments seem very much nebulous afterthoughts unsupported by authorities and are hard to follow. We fail to understand, for example, his point about all land in Hong Kong being leasehold except St John's Cathedral. Is Mr Tze trying to argue that because all land in Hong Kong are leasehold, interest in land can only be 'revenue in nature'? If so, then we have no hesitation in rejecting such unsubstantiated argument.

46. In Mr Tze's 'Supplemental Submission' dated 16 March 2018 (filed on 19 March 2018) he now sought to argue that the Company G Sub-Lease was in substance an assignment.

47. Mr Leung objected to the Appellant raising this argument for the first time on the ground that it was not part of the grounds of appeal.

48. The Appellant advanced 3 grounds of appeal:

(1) The Commissioner failed to look at the substance of the subletting business of the Appellant and erred in arriving at the view that the Sum/part of the Sum was capital in nature and was not deductible;

(2) The Commissioner failed to consider and/or sufficiently considered that the Sum/part of the Sum was outgoing and expenses for the production of the subletting business, and should be deducted as revenue expenses.

49. The third was a general ground that the assessments were excessive.

50. We think there are merits in Mr Leung's objection and we agree that it is unfair to the Commissioner to allow the Appellant to raise such an argument at such a late stage. Mr Tze in his 'Reply Submission' filed on 20 March 2018 argued that ground (1) covered the argument. We do not see how. An examination of '*the substance of the subletting business of the Appellant*' is very different from an examination of the legal characterisation of the Company G Sub-Lease. Mr Tze further argued that the evidence and written submissions made clear the argument. We do not agree. As stated above, at the Hearing Mr Tze accepted that there was no assignment and that was why we were left confused of his case. In any event, he never sought to amend the grounds of appeal. As such the Appellant is bound by them. For an authority that an appellant is not permitted to rely on a new ground which was not contained in the grounds of appeal, see China Map Limited v CIR (2008) 11 HKCFAR 486, CFA, paragraphs 9 & 10.

51. Further and in any event, upon further consideration of the facts, we agree with Mr Leung that whether the Company G Sub-Lease operated as a sublease or an assignment does not matter. By the Sum, the Appellant acquired the right to enter into the Head Lease, and by means of the Head Lease, the Appellant was able to earn a new source of income, namely a steady flow of rental income. The principal asset was the Head Lease and the right to earn rental income under it. Whether this rental income was earned by means of a subletting or an assignment in law is irrelevant. This is the classic case of the acquisition of a capital asset.

52. Our conclusion is supported by an examination of the various tests propounded in the authorities:

(1) The Sum was a once and for all payment, albeit payable by instalments.

(2) The Sum brought into existence an asset or an advantage for the enduring benefit of the business, namely the right to enter into the Head Lease, by which the Appellant could earn a steady rental income which endured until the expiration of the Head Lease. This steady income flow continued whether the Company G Sub-Lease was in substance a subletting or an assignment.

(3) The Sum was part of the Appellant's profit-yielding structure, namely the acquisition of the very asset which enabled the Appellant to expand its business into that of property subletting, which is just another name for a rental income business. While it earned only agency and consultancy fees before, the Head Lease had enabled the Appellant to generate this new source of income. The Sum was not part of the regular outlays necessary to maintain a process that brought in regular income.

(4) The Head Lease was a fixed asset which generated rental income for the Appellant without further action. It was not an asset which the Appellant had to circulate over and over in order to earn an income.

(5) The Sum was equivalent to a lease premium. '*There is no magic in the use of the word "premium"; it merely means a lump sum paid as a consideration for the acquisition of the lease.*' By the Sum the Appellant secured an agreement with the previous tenant, i.e. Company F, by which (1) Company F agreed to surrender its tenancy to the Landlord on condition that (2) the Landlord would enter into the Head Lease with the Appellant, thereby enabling the Appellant to acquire the tenancy of the Shop, i.e. an interest in land, which is a capital asset. The Sum was equivalent to a lease premium and was a capital expenditure.

53. The Sum satisfied the various tests and was plainly a capital expenditure.

54. In total, we find 3 objections to Mr Tze's argument that the Company G Sub-Lease operated as an assignment:

(1) As stated above, we agree it is unfair to the Commissioner to allow this argument at such a late stage. In light of Mr Leung's objection, we reject the argument.

(2) In any event, as explained above, this argument does not affect our conclusion above that the Sum was expended to acquire a capital asset and was thus a capital expenditure.

(3) Further and in any event, the argument is ill-considered and fails to answer the many questions relating to the option, the covenant against assignment and subletting and the Surrender Agreement.

55. According to Megarry, The Law of Real Property, 2012 ed., paragraphs 17-142 and 17-143, '*since the distinction between an assignment and a sub-lease is one of substance, not one of form, it follows that if the tenant disposes of the whole residue of his estate, the transaction must operate as an assignment even though the parties intend it to operate as a sub-lease. ... ... This rule applies only where the tenant creates an interest which is certain to last as long as, or longer than, his own.*'

56. Mr Tze argued that both the Head Lease and the Company G Sub-Lease were for one term of 8 years. We do not agree. An option remains an option unless and until it is exercised. At the date of the Company G Sub-Lease, the Appellant had not exercised its option. Its estate in the Shop remained a fixed term of 2 years with an option to renew for three further terms of 2 years each. It transferred to Company G a term of 6 years with an option to renew for one term of 2 years. In such circumstances, did the Company G Sub-Lease create an interest '*certain to last as long as, or longer than*', the Appellant's own interest under the Head Lease? We have grave doubt that it did. Mr Tze has not provided us with any authorities on the effect of an option.

57. Another difficulty we have is that while the Appellant was entitled under the Head Lease to assign and sublet, under the Company G Sub-Lease, Company G was prohibited to do so. A covenant against assignment and subletting is a covenant that runs with the land. The Appellant had thus imposed a more onerous covenant on Company G than what it was bound to under the Head Lease. It could, of course, do so under a sublease because a sublease creates a new tenure; but could it do so under an assignment? Can a sublease operate as an assignment in law when the sublease contains more onerous covenants than the head lease? We have grave doubt that it can. Mr Tze has not considered this question at all, and we have no authorities to assist us.

58. Further, when Company G terminated the sublease after only 2 years, it did so by means of a surrender, which is 'an assurance by which a lesser estate is yielded up to the greater'.[4] The surrender was not to the Landlord, but to the Appellant. The Surrender was plainly done on the premise that the Company G Sub-Lease operated as a sublease and not as an assignment. So how did it affect the operation of the Company G Sub-Lease as an assignment? Again Mr Tze has not dealt with this question, and we have no authorities to assist us.

59. In the same connection we refer to the Company H Sub-Leases. Little reference was made to them during the Hearing. They were not even included in the bundle of documents and were only handed to us at the beginning of the Hearing. In all of Mr Tze's submissions, he made but passing reference to them. We are not sure what the Appellant's case is regarding them. Did the Company H Sub-Leases also operate as assignments? If so, how did the Appellant assign or 'sell' the Head Lease to Company H if it had already

[4] Barrett and Others v Morgan [2000] UKHL 1; [2000] 2 AC 264; [2000] 1 All ER 481; [2000] 2 WLR 285

assigned or 'sold' the Head Lease to Company G? Why and how did the Appellant 'sell' the Head Lease to Company H twice? These questions tied in with the question above about the effect of the Surrender Agreement. Mr Tze has not dealt with these questions at all.

60. In light of the other objections to the argument, it is not necessary for us to come to a definitive answer to these questions. But if we have to answer them, we are inclined to the view that the answer points to the Company G Sub-Lease being in form and in substance a subletting and not an assignment. The burden is on the Appellant to prove the argument. With these questions unanswered, the Appellant has failed to persuade us otherwise.

61. After Mr Tze filed his 'Reply Submission', he filed a further submission on 23 March 2018, called his 'Final Submission'. In that he stated: 'It is not in dispute that the Appellant was carrying on a sub-letting business, no matter the sub-letting amounted to an assignment or not.' So it seems that he now accepted that 'the substance' of the Appellant's business was one of subletting.

62. In this 'Final Submission' he relied on a decision of the Board of Review in D170/98. We do not see how that case assists the Appellant.

63. D170/98 was a case where a tenant paid a sum to the landlord taxpayer as compensation for its premature termination of the tenancy. The Board there found that such a compensation was revenue in nature.

64. This authority would be relevant if we were considering a case where, for example, Company F had paid a sum to the Landlord as compensation for Company F's early termination. This is not the case here.

65. Mr Tze argued that '*the Sum was paid to [Company F] for its loss of profitable use of the Shop in the course of the sub-letting business of the Appellant*' and that '*the Sum is used to discharge the responsibilities between the Landlord and [Company F] in the course of the sub-letting business of the Appellant and thus, revenue in nature.*' We do not follow these arguments. The Sum was not paid as compensation. It was paid under a separate and distinct agreement between Company F and the Appellant as an inducement to Company F to agree to enter into an agreement with the Landlord to (1) surrender its tenancy on condition that (2) the Landlord would enter into the Head Lease with the Appellant.

66. Further, we have to look at the nature of the Sum as concerns the Appellant, not the nature of the Sum in the hands of Company F. It is trite law that the same transaction can produce different fiscal consequences for the parties. If a property dealer in the business of buying and selling properties sells a shop to a retail company who purchases the shop to carry on its retail business, the purchase price for the shop in the hands of the property dealer is clearly a revenue income, but for the purchaser, it is clearly a capital expenditure.[5]

[5] E.g. Compare CIR v Church Commissioners (1976) 50 TC 516, HL with CIR v Land Securities Investment Trust (1969) 45TC 495, HL, cited in Bluesparkle Ltd v Revenue & Customs [2012] UKFTT 45 (TC) (12 January 2012), paragraph 29

67. As far as concerns the Appellant, the Sum was paid to acquire a capital asset, namely the right to enter into the Head Lease, which is an interest in land. It was a capital expenditure.

Conclusion

68. In conclusion, we find that this is a clear case that the Sum was a capital expenditure and thus not deductible under section 16(1) of the IRO by virtue of section 17(1)(c).

69. Under section 68(8)(a) of the IRO, we confirm the assessments appealed against and dismiss the appeal.

70. We agree with Mr Leung that the appeal has little merits. Under section 68(9) of the IRO, we order the Appellant to pay as costs of this Board a sum of HK$20,000 which shall be added to the tax charged and recovered therewith.

71. It remains for us to thank Counsel on both sides for their assistance.