Case No. D7/16

Case stated – whether questions proposed are proper questions of law – whether arguable and fit for the opinion of the Court of First Instance – section 69(1) of the Inland Revenue Ordinance ('IRO').

Panel: Chui Pak Ming Norman (chairman), Jonathan Lee and Gladie Lui.

Date of hearing: Stated case, no hearing.
Date of decision: 18 May 2016.

The Board, by its Decision of 7 December 2015, dismissed the Appellant's appeal and rejected its contention that certain expenditure incurred on the purchase of moulds, as outgoings and expenses or as specified capital expenditure, in computing its assessable profits. The Appellant's alternate claim that it should be granted depreciation allowances on such expenditure was also rejected.

The Appellant applied to the Board to state a case on 8 questions of law for the opinion of the Court of First Instance.

Held:

1. A proper question of law is one which:

   - is a question of law;

   - relates to the decision sought to be appealed against;

   - is arguable; and

   - would not be an abuse of process for such a question to be submitted to CFI for determination.

2. None of the eight questions proposed by the Appellant is a proper question of law.

   - Question 1 is no more than an attack on the findings of fact. The Appellant failed to state how the Board had erred in law.

- Question 2 is imprecise. It is no more than an attack on the finding of the Board that the Expenditure is a capital expenditure.

- Questions 3, 4 and 5 are too general and ambiguous requiring the Board to annex the whole of the evidence to the case stated.

- Question 6 is misleading and vague.

- Question 7 is an academic question. Even if it is not, Question 7 is not arguable and not fit for the opinion of the Court of First Instance.

- Question 8 is a catch-all question. It is improper and undesirable for the Board to frame or propose any question of law.

Application dismissed.

Cases referred to:

Commissioner of Inland Revenue v Inland Revenue Board of Review and another [1989] 2 HKLR 40
Aust-Key Co Ltd v Commissioner of Inland Revenue [2001] 2 HKLRD 275
Honorcan Limited v Inland Revenue Board of Review [2010] 5 HKLRD 378
Tungtex Trading Co Ltd v Commissioner of Inland Revenue [2012] 2 HKLRD 456
Commissioner of Inland Revenue v Common Empire Ltd [2007] 1 HKLRD 679

Decision:

Introduction

1. The appeal was brought by the Appellant against the determination of the Deputy Commissioner of Inland Revenue dated 12 March 2015 ('Commissioner'). We heard the appeal on 31 August 2015 and handed down our decision on 7 December 2015 ('Decision') and dismissed the appeal. A copy of the Decision is annexed hereto.

2. The Clerk to the Board of Review on 6 January 2016 received a letter dated 6 January 2016 from Messrs Kitty So & Tong, Solicitors for the Appellant which purported to be an application under section 69(1) of the Inland Revenue Ordinance, Chapter 112 ('Ordinance'), requiring the Board to state a case on law for the opinion of the Court of First Instance on the questions of law set out in the paragraphs to follow ('Application'). In the Application, the Appellant set out eight questions of law for the opinion of the Court of First Instance.

3. We then gave directions to the parties to file submissions on the proposed questions of law. The Respondent made submissions to the Board by way of a letter dated 17 February 2016, commenting on the questions of law proposed in the Application ('Commissioner's Submission').

4. Reply submission was made by the Appellant, through its solicitors' letter dated 16 March 2016 ('Reply Submission').

5. The Board has carefully considered the Application, Commissioner's Submission and Reply Submission.

Relevant Laws and Guiding Principles on Applications for Cases Stated

6. Under section 69(1) of the Inland Revenue Ordinance ('the IRO'), the Appellant or the Commissioner of Inland Revenue may make an application requiring the Board to state a case on a question of law for the opinion of the Court of First Instance.

7. Broadly speaking, there are three principal ways that a party can mount against the Board's decision under section 69(1) according to the Aspiration Case[1], namely:

(a) The Board's decision can be impugned if it has misdirected itself in law, for example, upon the burden of proof, or by misinterpretation of a statute.[2]

(b) The Board's decision can be challenged if it has drawn inferences or come to conclusions which cannot stand because the primary facts found by it do not admit of such inferences or conclusions, or because the primary facts or inferences, or a combination, do not admit of the final conclusion.[3]

(c) A challenge can be made to the Board's decision where there was no evidence on which the primary facts themselves could be based. Alternatively, it may be contended that the Board should have made findings of other relevant facts.[4]

8. In the Aspiration case, Barnett J also laid down the following principles when he said[5]:

'*After reviewing the authorities and carefully considering the arguments which*

[1] CIR v Inland Revenue Board of Review and Another [1989] 2 HKLR 40 (commonly referred to as the Aspiration case)
[2] at 57F
[3] at 57F
[4] at 57G
[5] at 57H-58A

have been addressed to me, I am satisfied of the following matters:

(1) An applicant for a case stated must identify a question of law which it is proper for the High Court to consider.

(2) The Board of Review is under a statutory duty to state a case in respect of that question of law.

(3) The Board has a power to scrutinize the question of law to ensure that it is one which it is proper for the court to consider.

(4) If the Board is of the view that the point of law is not proper, it may decline to state a case.

(5) If an applicant wishes to attack findings of primary fact, he must identify those findings.

(6) Only in most exceptional circumstances should a complete transcript of the evidence and the documents produced before the Board be attached to or incorporated in the case stated.

(7) Both an applicant and the Board should be astute to use "facts" and "evidence" correctly.'

9. It is clear from the Aspiration case that:

(a) It is incumbent on an applicant for a case stated to identify a question of law which is proper for the Court of First Instance to consider. It is not for the Board to frame questions for an applicant. The reason is obvious: the parties know better than anyone else what points they wish to take on the appeal.[6]

(b) A satisfactory question has to be identified so as to trigger the preparation of the case. It is not permissible for the applicant simply to say that there must be a point of law which will arise for consideration by the Court of First Instance.[7]

(c) The questions the Court is asked to answer 'should be stated clearly and concisely and care should be taken to ensure that the questions are not wider than is warranted by the facts'[8].

[6] at 48I
[7] at 47H
[8] at 48E

(d) An applicant for a case stated may not rely on a question of law which is imprecise or ambiguous and which gives the Board no clear idea of what material must be marshalled in their case[9].

(e) The Board is not to be treated as a mere cipher[10].

(f) It is wholly impermissible to go beating about the evidential undergrowth in the hope of flushing out some useful pieces of evidence that support an applicant's view, in total disregard of settled law that the Board's findings of primary fact, in so far as there is any evidence to support them, are sacrosanct[11].

10. As per Chung J in Aust-Key Co Ltd case[12], a proper question of law is one which:

(a) is a question of law;

(b) relates to the decision sought to be appealed against;

(c) is arguable; and

(d) would not be an abuse of process for such a question to be submitted to CFI for determination.

11. Chung J further observed that[13] :

'*There is no complaint that the Board's finding is irrational or perverse and I do not consider any such complaint can be validly made. As a tribunal of fact:*

(a) The extent to which a piece of evidence should be accepted;

(b) The extent to which a piece of evidence should be rejected;

(c) The use to which the evidence which has been accepted by the Board should be put;

are all the matters falling within the Board's jurisdiction and are matters for it to decide'.

12. A proper question of law is one which is not just a question of law and relates to the decision sought to be appealed against, but also an arguable question and would not be

[9] at 50G
[10] at 54H
[11] at 58F
[12] Aust-Key Co Ltd v Commissioner of Inland Revenue [2001] 2 HKLRD 275 at 283B
[13] At page 281G-H

an abuse of process for such a question to be submitted to the Court of First Instance for determination. As per Fok J (as he then was) in Honorcan Limited case[14]:

> (a) The question here is whether the Board was correct in holding that section 69(1) of the Ordinance required it to apply a qualitative assessment to the proposed questions of law which the applicant sought to have referred to the Court for its opinion and, if so, whether the Board correctly applied the relevant test in reaching the conclusion that the proposed questions of law were not proper ones for the opinion of the Court.[15]
>
> (b) As will be apparent from the cases cited above, it has not been held that the right of appeal under section 69(1) of the Ordinance is unqualified and absolute.[16]
>
> (c) In my judgment, the Board is duty bound to decline to state a case if the question of law proposed to be stated is not a proper one, as the authorities have consistently held. A question proposed to be stated may, it seems to me, be improper for various reasons, as illustrated in the cases discussed above: it may be irrelevant or premature; it may be academic to the outcome of the appeal; it may be embarrassing; it may be plainly and obviously unarguable.[17]
>
> (d) If the Board did not have a duty to decline to state a case where a party sought to require it to state a case on a wholly unarguable question of law, there would inevitably be a risk of frivolous appeals being pursued in the Court of First Instance by way of the case stated procedure. I do not discern any intention in section 69(1) of the Ordinance that this should be the position.[18]

13. In Tungtex Trading Co Ltd v Commissioner of Inland Revenue[19], Barma J applied Honorcan and held that if the Board is satisfied that the argument has no prospect of success, it is not bound to include it amongst the questions that it poses for consideration of the Court.[20]

[14] Honorcan Limited v Inland Revenue Board of Review [2010] 5 HKLRD 378
[15] Paragraph 34
[16] Paragraph 49
[17] Paragraph 50
[18] Paragraph 53
[19] [2012] 2 HKLRD 456
[20] Paragraph 31

The Application

14. As said in the above, there are 8 legal questions set out in the Application for the opinion of the Court of First Instance. We will analyze each question in the order raised in the Application as below.

15. **Question 1:** 'Whether the Board of Review misdirected itself in law and/or erred in law in finding that the appellant failed to submit unequivocal evidence to substantiate mistakes in its financial statements classifying the expenditure incurred by the appellant on the purchase of moulds ("Expenditure") as "property, plant and equipment" under "non-current assets", in circumstances where:

(1) Whether the Expenditure is capital or revenue expense is a question of law, and what is required by way of accounting standard in a financial statement may not reflect the nature of the item of expenditure for the purpose of profit tax under the Ordinance.

(2) The Inland Revenue Department ("IRD") adopted the same stance in its DIPN No 42 (at paragraph 27) which states:

"Whether the expenditure is capital or revenue in nature is a question of law. The accounting treatment will not determine the nature of the expenditure".

(3) There are no "mistakes" in the appellant's financial statements that the appellant needs to "substantiate", given the Expenditure was properly classified therein in accordance with ordinary principles of commercial accountancy. There is a clear difference (which the Board of Review failed to appreciate) between what is required by way of accounting standards in a financial statement so as to present a full picture on the financial position of the appellant, and what amounts to a deductible expense in law for the purpose of profits tax under the Ordinance.'

16. According to the agreed and undisputed facts of the appeal, in the Appellant's balance sheets as at 31 October 2003 to 2007, the moulds were classified as 'property, plant and equipment' under 'non-current assets'. The notes to the financial statements stated that the estimated useful life of the moulds was 60 months from the start of production[21]. It was also stated in the Appellant's report and financial statements that when assets are sold or retired, their cost and aggregate depreciation and accumulated impairment losses are removed from the financial statements and any gain or loss resulting from their disposal is included in the income statement. It was also not challenged by the Appellant that the said reports and financial statements did not reveal any disposal of moulds save for the year of assessment 2006/07 which was $45,500 only (which was minimal compared with the amount of additions over the years).

[21] Paragraph 5(3)(e) of the Decision

17. The Board agrees with paragraph 3 of the Reply Submission that whether an item is a deductible expense is a question of law. In fact, the Board duly applied the law on the facts found by the Board (being the agreed facts) and came to the conclusion that the Appellant treated the Expenditure as a capital expenditure.

18. The Appellant only complained that there were no 'mistakes' in its financial statement that it needed to 'substantiate' given the Expenditure was properly classified therein in accordance with ordinary principles of commercial accountancy. However it does not state how the Board had erred in law in arriving at its conclusion on the basis of the facts found by the Board. Neither does the Appellant state how the Board misdirected itself in law; or how the conclusion made by the Board which no person acting judicially and properly instructed as to the relevant law could have made, or what primary facts the Board made which was unsupported by any evidence; or what primary fact the Board failed to make where the evidence pointed only to such a finding.

19. The Appellant alleged further that there is a clear difference (which the Board of Review failed to appreciate) between what is required by way of accounting standards in a financial statement so as to present a full picture on the financial position of the Appellant, and what amounts to a deductible expense in law for the purpose of profits tax under the Ordinance. However, there is no evidence of such 'clear difference'. The Appellant does not state how the Board erred in law or misdirected itself in law in arriving at its conclusion even assuming that there is a 'clear difference'.

20. The finding of the Board that the Expenditure was 'property, plant and equipment' under 'non-current assets' was based on the facts found by the Board (namely, the agreed facts) and the application of the guiding legal principles referred to by the parties at the hearing of the appeal on the facts found. The Board did not make the finding on the fact that the Appellant failed to submit evidence to substantiate its arguments.

21. In short, Question 1 is no more than an attack on the findings of fact which does not fall into any one of the three categories in the Aspiration case. Question 1 raises no valid question of law.

22. **Question 2:** 'Whether the Board of Review misdirected itself in law and/or erred in law in finding that the appellant submitted no evidence to substantiate its arguments that the Expenditure was revenue in nature, in circumstances where:

(1) The indicia of the Expenditure being revenue in nature as summarized in para 10 of the Decision were:

(a) derived from undisputed facts in the Determination; or

(b) derived from representations made by tax representatives of the appellant to the IRD which were not challenged or disputed by the Commissioner of Inland Revenue ("CIR").

(2) The Board of Review erroneously found that the accounting treatment of the Expenditure undermined the appellant's case.'

23. It is a fact that the Appellant submitted no evidence at the hearing save that it agreed that the documents annexed in the hearing bundles formed part of the evidences of the appeal. The Appellant confirmed that it relied on the facts set out in paragraph 5 of the Decision which were agreed to by the Appellant.

24. The conclusion that the Expenditure was a capital expenditure and was not deductible under section 16(1) of the Ordinance was drawn by the Board by applying the guiding legal principles submitted by the parties on the agreed facts (paragraph 15 of the Decision). The Board did not come to the conclusion on the basis of the Appellant's failure to submit evidence to substantiate its argument nor did the Board come to the conclusion that the accounting treatment of the Expenditure undermined the Appellant's case.

25. The arguments put forward by the parties had not been agreed. The facts recited in paragraph 5(3)(c) of the Decision showed that there were certain acts done by the Appellant or the documents submitted by the Appellant to the CIR had certain representations. Such acts or the existence of the documents were agreed to by the parties. However, the contents of the acts or representations had not been agreed to by the parties, at least by the CIR. If the Appellant's representations were agreed to by the CIR, there would not be an appeal and the matter could have been resolved in the course of its dealing with the CIR. To be fair to the parties that the Board had duly considered the representations made by the parties or the contents of the documents submitted, the Board recited their representations or contents of the documents involved in its Decision. The Board, in arriving at the Decision, had duly considered the representations or contents of the documents involved.

26. If the Appellant wishes to contend that the Board should have made further findings, it should have included a question on the findings which the Appellant contends the Board should have made so as to enable the Board to decide on the evidence which the Board should marshal in stating the case.

27. As said in paragraph 24 hereof, the Board did not make any finding that the accounting treatment of Expenditure undermined the Appellant's case. The Board came to the conclusion on the basis of the facts found by the Board (namely, the agreed facts). The Appellant's representations made to the Board at the hearing were set out at paragraphs 10 to 12 of the Decision. However, such representations were not supported by submission of evidence on the part of the Appellant (other than the facts agreed to by it).

28. Question 2 is therefore based on erroneous premises that the Board came to the conclusion by reason of the fact that the Appellant submitted no evidence to substantiate its argument that the Expenditure was revenue in nature and on the ground that the accounting treatment of the Expenditure undermined its case. Question 2 is no more than an attack on the finding of the Board that the Expenditure is a capital expenditure. Further, on the face of Question 2, it is imprecise. It does not state how the Board had erred in law in arriving at its conclusion on the basis of the facts found by the Board. Neither does the Appellant state how the Board misdirected itself in law; or how the conclusion made by the Board which no person acting judicially and properly instructed as to the relevant law could have made, or what primary facts the Board made which was unsupported by any evidence; or what primary fact the Board failed to make where the evidence pointed only to such a finding.

29. By reason of the aforesaid, Question 2 is misconceived and clearly not a question of law proper for the Board to state for the opinion of the Court of First Instance.

30. **Question 3:** 'Whether in law and based on all evidence before the Board of Review, the true and only reasonable conclusion is that the Expenditure is capital in nature.'

31. There are two objections to this question.

32. Firstly, by paragraph 15 of the Decision, the Board had made it clear that the only logical conclusion made by the Board is that the Expenditure is a capital expenditure. Such logical conclusion (being an inference) was based on the agreed facts set out in paragraph 5 of the Decision and the documents annexed in the hearing bundles. As such, the correct question is not 'whether the true and only reasonable conclusion is that the Expenditure is capital in nature'. The correct question is whether 'the true and only reasonable conclusion contradicts' the determination appealed against (in the present case, namely '*the conclusion that the Expenditure is capital in nature*'), see Kim Eng Securities (Hong Kong) Ltd v CIR [2007] 2 HKLRD 117 at paragraph 55, quoting Kwong Mile Services Ltd v CIR (2004) 7 HKCFAR 275 at pages 288D-E and 291J-292B and Edwards (Inspector of Taxes) v Bairstow & Another [1956] AC 14 at page 36. Accordingly the Board agrees with the Commissioner's Submission that Question 3 is a wrong question.

33. By paragraph 12 of the Reply Submission, the Appellant conceded to amend Question 3 to 'Whether in law and based on all evidence before the Board of Review, the true and only reasonable conclusion is that the Expenditure is not capital in nature.' However, in our view, such amendment will not cure the second objection according to the second objection which the Board states in the next paragraph.

34. The second objection is simple and straight forward. In the Aspiration case decided by Barnett J, the third question proposed by the applicant was in the following terms:

> *'(iii) Whether on the whole of the evidence before the Board the only proper conclusion was that the sum of $344,825,190 received by Aspiration*

Land Investment Ltd. was profit changeable to tax in accordance with s. 14 of the Inland Revenue Ordinance?'

Barnett J decided that an applicant could not rely on a question of law which was imprecise or ambiguous and which gave the Board no clear idea of what material was to be marshalled in support of the applicant's case. He ruled that the third question was not a proper question of law. As it stood, that question required the Board to annex the whole of the evidence to the case stated. He also held that, on the authorities, the Board only needed to give a general indication of the evidence relied on in reaching any finding of primary fact. If the Board were able to indicate the existence of such evidence, that was the end of the matter. The court was not permitted to re-evaluate that, or any other evidence, to see whether it might have made a different finding.

35. The conclusion that the Expenditure was a capital expenditure was a result of applying the guiding principles on the agreed facts by the Board (See paragraph 15 of the Decision).

36. The Board is of the view that Question 3 in the present case is substantially similar to the 3rd question referred to in the Aspiration case. It is too general and ambiguous. It would require the Board to annex the whole of the evidence to the case stated.

37. The Board therefore does not think that Question 3 is a proper question of law for the opinion of the Court of First Instance.

38. **Question 4:** 'Even if the Expenditure is capital in nature, whether in law and based on all evidence before the Board of Review, the true and only reasonable conclusion is that the Expenditure is an excluded fixed asset as defined in section 16G of the Ordinance, in particular whether any person holds rights in the appellant's moulds "as a lessee under a lease", such that its deduction is disallowed.'

39. Again, this question attracts two objections.

40. Firstly, this question is objected in the same manner on the reason set out in paragraph 32 hereof. The proper question should be '…whether in law and based on all evidence before the Board of Review, the true and only reasonable conclusion contradicts the finding that the Expenditure is an excluded fixed assets…'. By paragraph 14 of the Reply Submission, the Appellant conceded to amend Question 4 to 'Even if the Expenditure is capital in nature, whether in law and based on all evidence before the Board of Review, the true and only reasonable conclusion is that the Expenditure is not an excluded fixed assets as defined in section 16G of the Ordinance, in particular whether any person holds rights in the appellant's moulds "as a lessee under a lease", such that its deduction is disallowed'. Again, in our view, such amendment will not cure the second objection the Board states in the next few paragraphs.

41. The second objection is also simple and straight forward. The conclusion that the Expenditure is an excluded fixed assets as defined in section 16G of the Ordinance was based on the undisputed or agreed facts of the case (See paragraph 22 of the Decision).

42. The Board is of the view that Question 4 in the present case is substantially similar to the third question referred to in the Aspiration case. It is too general and ambiguous. It would require the Board to annex the whole of the evidence to the case stated.

43. The Board therefore does not think that Question 4 is a proper question of law for the opinion of the Court of First Instance.

44. **Question 5:** 'Whether in law and based on all evidence before the Board of Review, the appellant is entitled to depreciation allowances for the Expenditure pursuant to sections 18F and 39B of the Ordinance and IRD's practice in DIPN No 15.'

45. Again, this question attracts two objections.

46. The first objection to this question is same as the reason stated in paragraph 32 hereof.

47. The second objection is that the conclusion that the Appellant is not entitled to depreciation allowances for the Expenditure pursuant to sections 18F and 39B of the Ordinance and IRD's practice in DIPN No 15 was based on the application of relevant laws on the undisputed facts of the case (see paragraph 26 of the Decision).

48. The Board is of the view that Question 5 in the present case is substantially similar to the third question referred to in the Aspiration case. It is too general and ambiguous. It would require the Board to annex the whole of the evidence to the case stated. The Board does not think that Question 5 is a proper question of law for the opinion of the Court of First Instance.

49. **Question 6:** 'Whether in law it is open to the CIR to charge the appellant additional profits tax for the years of assessment 2006/07 and 2007/08, computed on the basis of re-opened and revised 2003/04, 2005/06 profits tax assessments on the appellant when the CIR was statutorily barred from doing so whether under section 60 or section 70A of the Ordinance.'

50. By paragraph 33 of the Reply Submission, the Appellant reframed Question 6 as: 'Whether the Board erred in law in confirming the additional profits for the years of assessment 2006/07 and 2007/08 without taking into account the unrelieved loss brought forward from 2003/04 that had been wrongly revised by the CIR.'

51. Both the new and the revised Question 6 were based on the argument that the CIR was barred from revising a statement of loss or had performed wrong revisions of statements of loss in the years of assessment from 2003/04 to 2005/06.

52. In the Notice of Appeal before the Board, the Appellant did not take issue on the revision of statements of loss in the years of assessment from 2003/04 to 2005/06. Neither did the Appellant have leave under section 66 of the Ordinance to take such revisions in issue at the Appeal hearing. The Appellant should therefore be estopped from taking the issue of revision of statements of loss in disguise of an issue of revision of assessment.

53. Further, the Board agrees with the Commissioner's Submission that the revision of the earlier 'statement of loss' is not an 'assessment' for the purpose of section 60 according to the principle endorsed by the Court of Appeal in Commissioner of Inland Revenue v Common Empire Ltd.[22] As such, section 60 does not bar the CIR from making a revision of statement of loss. The Board is bound by the decision of 'Common Empire'.

54. Question 6 is predicated on the basis that CIR was statutorily barred from re-opening and revising the 'statements of loss' in disguise of **tax assessments** and is therefore misleading and vague.

55. By reason of the aforesaid, the Board does not think that it is a proper question of law for the opinion of the Court of First Instance.

56. **Question 7:** 'Whether the Board of Review misdirected itself in law and/or erred in law in finding the appellant required leave from the Board of Review to advance its argument under question 6 above when (as the CIR argued and as appears to be accepted by the Board of Review) the appellant "did not take issue" on the profits tax assessments for 2003/04 to 2005/06 in the Notice of Appeal.'

57. On the face of it, it appears that Question 7 is a question of law. However, the Board has to decide whether the question of law is arguable and proper for the opinion of the Court of First Instance before it states the case.

58. At the hearing of the Appeal, the Respondent submitted that the Appellant did not take issue on '***the revision of statement of loss***' in the years of assessment from 2003/04 to 2005/06 in the Notice of Appeal, not as alleged in Question 7 that the Appellant did not take issue on '***the profits tax assessments***' 2003/04 to 2005/06 in the Notice of Appeal (See paragraph 32 of the Decision).

59. By paragraph 34 of the Reply Submission, the Appellant submitted that no leave is required for the Appellant to argue before the Board in the appeal that the CIR was not entitled to reduce the Appellant's declared loss carried forward for the years 2003/04, 2004/05 and 2005/06, when the point was already taken by the Appellant in paragraph 6(iii) and paragraph 7 of the Notice of Appeal.

[22] [2007] 1 HKLRD 679

60. Paragraph 6(iii) of the Notice of Appeal provides *inter alia*, 'The Commissioner has a duty to act fairly in terms of 64(2) as decided in Aviation Fuel Supply Company and CIR, FACV 14 of 2013. This duty is not restricted only to act timely. Here he has failed this duty including, by … (iii) revising assessing losses in 2015 which is about 11 years from 2003/04'.

61. Paragraph 7 of the Notice of Appeal provides *inter alia*, 'There are unrelieved losses carried forward to set off against the assessable profits of the years of assessment 2006/07 and 2007/08. Firstly, there is no error committed by predecessor assessors at the relevant times. Secondly, it is wrong and unfair to correct them in 2015.'.

62. The contents of paragraph 6(iii) suggest no more than 'the Commissioner failed to act fairly by revising assessed losses in 2015 which is about 11 years from 2003/04'. The contents do not tell how the Commissioner committed a mistake by revising assessing losses in 2015 which is about 11 years from 2003/04 and how the Appellant would argue that the Commissioner was wrong by revising losses which were assessed 11 years ago.

63. The contents of paragraph 7 of the Notice of Appeal suggested no more than 'it is wrong and unfair for the Commissioner to revise assessed losses in 2015' (which were losses that happened in many years ago).

64. The real issue is 'whether the Commissioner is barred from revising a statement of loss under section 60 of the Ordinance when the statement of loss was assessed outside the limitation period'.

65. Paragraph 6(iii) and paragraph 7 of the Notice of Appeal are too general that the Board or the Commissioner could not get the real issue, namely, 'the Commissioner is barred from revising the statement of loss under section 60 of the Ordinance when the statement of loss was assessed outside the limitation period'. As such, leave should be sought and granted before the Appellant was allowed to pursue its argument that the Commissioner is barred from revising the statement of loss under section 60 of the Ordinance when the statement of loss was assessed outside the limitation period.

66. At the Appeal hearing, the Board did not feel that it was an appropriate case that leave should be given to the Appellant (to argue the issue of 'revision of statement of loss') because the Common Empire case (relied on the Appellant) did not assist the Appellant's argument.

67. The Board is bound by the Court of Appeal decision in Common Empire that *the statement of loss is simply an administrative document which has no statutory force* and therefore is not time-barred by the Commissioner in applying 'the loss' stated therein against the amount of assessable profits for subsequent years of assessment of a taxpayer.

68. For the reasons aforesaid, it is an academic question whether leave is required to pursue the revision of a statement of loss which was assessed outside the limitation period

under section 60 of the Ordinance. Even if the Board errs in its decision that leave is required, the decision of Common Empire is a binding authority that Question 7 is not arguable and not fit for the opinion of the Court of First Instance.

69. **Question 8:** 'Such further or incidental questions of law to the question above as may be framed or proposed by the Board of Review, the appellant and/or the CIR in the stated case to be prepared and issued by the Board of Review.'

70. The Board agrees with the Commissioner's Submission that this is a catch-all question which leaves the Board to state any further question of law proper and pertinent in this case.

71. It is improper and undesirable that the Board is to frame or propose any question of law for the opinion of the Court of First Instance. As Bennett J said in the Aspiration case, 'it is incumbent on an applicant for a case stated to identify a question of law which is proper for the CFI to consider. It is **not** for the Board to frame questions for an applicant. The reason is obvious: the parties know better than anyone else what points they wish to take on the appeal.'[23]

72. The Board therefore states no question of law as requested in Question 8.

Conclusion

73. By reason of the aforesaid, the Board dismisses the application of the Appellant to state a case for the opinion of the Court of First Instance.

[23] Paragraphs 48I to J

Annex
D19/15

BOARD OF REVIEW

Appeal by Company A

(Date of Hearing: 31 August 2015)

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D E C I S I O N

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Case No. D19/15

Profits tax – deduction of expenditure – depreciation allowance – sections 2, 15(1)(b), 16(1), 16G, 17(1)(c), 18F(1), 39B, 39E, 60, 64, 66 and 68 of Inland Revenue Ordinance ('the Ordinance')

Panel: Chui Pak Ming Norman (chairman), Jonathan Lee and Gladie Lui.

Date of hearing: 31 August 2015.
Date of decision: 7 December 2015.

The Appellant was a trader of toys. The Appellant made samples of toys to procure trading orders and engaged contractors to produce toys to fulfil the contracts. The Appellant provided moulds to the contractors and the contractors used the moulds to manufacture toys.

The Appellant acquired moulds from vendors who had factories in Mainland China. The mould vendors produced the moulds in Mainland China and delivered the moulds to the contractors' factories in Mainland China. The moulds were placed in the contractors' factories situated in Mainland China.

The Appellant claims that it should be allowed deduction for certain expenditure incurred on the purchase of moulds ('the Expenditure'), as outgoings and expenses or as specified capital expenditure, in computing its assessable profits. The Appellant alternatively claims that it should be granted depreciation allowances on such expenditure.

Held:

1. The evidence is that for the past years, the Appellant treated the Expenditure as a capital expenditure. If the Appellant wished to challenge that there were mistakes in its financial statements and declarations made by a director, it should substantiate such mistakes by unequivocal evidence but there was no such evidence. In the circumstances, the only logical conclusion made by the Board is that the Expenditure is a capital expenditure.

2. The undisputed arrangement between the Appellant and its manufacturers relating to the use of the mould owned by the Appellant to manufacture toys for the Appellant is that (a) the Appellant secured purchase orders of toys from customers; (b) the Appellant engaged mould vendors to build the moulds; (c) the Appellant authorized the manufacturers of toys to collect moulds from the mould vendors; and (d) the manufacturers used the moulds

to produce toys for the Appellant. There was a lease within the meaning of section 2 of the Ordinance between the Appellant and its manufacturers on the moulds concerned and the Expenditure (being held as a capital nature) is an excluded fixed asset (Braitrim (Far East) Limited v Commissioner of Inland Revenue [2013] 4 HKLRD 329 applied). It follows that the Expenditure is not deductible under section 16(G) of the Ordinance.

3. As to depreciation allowances under sections 18F and 39B of the Ordinance, the Appellant did not submit any evidence to substantiate that the arrangement of the using of the moulds by the Appellant's manufacturers in the mainland was based on contract processing agreements with its mainland Chinese manufacturers. Such contract processing agreements necessitate the formal approval by the relevant authorities in the Mainland China before the moulds could be imported to the mainland on a tax concessionary basis for the manufacturing of the Appellant's goods. Since the use of the moulds by the mainland manufacturers were not based on contract processing arrangement, there was no substance whatsoever in this claim.

Appeal dismissed and costs order in the amount of $5,000 imposed.

Cases referred to:

Braitrim (Far East) Limited v Commissioner of Inland Revenue [2013] 4 HKLRD 329

B P Australia Ltd v The Commissioner of Taxation of the Commonwealth of Australia [1965] 3 All ER 209

Nice Cheer Investment Ltd v Commissioner of Inland Revenue FACV 23/2012

Chinachem Investment Co Ltd v Commissioner of Inland Revenue [1987] 2 HKTC 261

Aviation Fuel Supply Company v Commissioner of Inland Revenue FACV 14/2013

Commissioner of Inland Revenue v Common Empire Limited CACV 83/2006

Tse Yue Keung of Settlewise Consultants, Alex Wong and Jason Ko of Messrs C B Wong & Co CPA, for the Appellant.

Suen Sze Yick, Acting Senior Government Counsel, and Minnie Wong, Acting Senior Government Counsel, of Department of Justice, for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal brought by the Appellant against the determination of the Deputy Commissioner of Inland Revenue dated 12 March 2015 ('Determination') whereby:

(i) Profits Tax Assessment for the year of assessment 2006/07 under Charge Number X-XXXXXXX-XX-X dated 18 March 2013 showing Assessable Profits of HK$20,727,659 with Tax Payable thereon of HK$3,627,340 was confirmed; and

(ii) Additional Profits Tax Assessment for the year of assessment 2007/08 under Charge Number X-XXXXXXX-XX-X, dated 18 April 2013, showing Additional Assessable Profits of HK$36,559 with Additional Tax Payable thereon of HK$1,600 was increased to Additional Assessable Profits of HK$4,704,430 with Additional Tax Payable thereon of $803,321.

2. By the letter of C B Wong & Co dated 8 April 2015 (erroneously stated as 8 April 2014) which was received by the Board of Review on 9 April 2015, the Appellant lodged a Notice of Appeal against the Determination.

3. The grounds of the Appeal raised by the Appellant and set out in the said letter were as follows:

(a) The assessments are incorrect or excessive.

(b) The expenditure on moulds is deductible under section 16(1), being part of the costs to produce assessable profits from sale of toys they made. Authorities suggest that the deciding factor is the profit making operations, not the accounting presentation or the useful life of the expenditure. Rule 2 of the Inland Revenue Rules decides only the rate of depreciation allowance applicable to capital expenditure.

(c) The moulds are deductible under section 16G; there is no evidence for the Commissioner to conclude that the manufacturer contractors 'hold right as a lessee'. They are instructed to use the moulds in the capacity of a contractor. It is incorrect that 'a person was allowed to use the assets by the owner would suffice' to be an excluded asset thereby omitting the words 'right' and 'lessee' used in the definition without interpretation or meaning.

(d) The Commissioner has gone too far by asserting that Braitrim (Far East)

Limited v CIR has decided that 'the arrangement under which the Taxpayer in that case allowed the manufacturer in Mainland China to use moulds to produce the taxpayer's products fell within the definition of a lease'. But, the court decided that 'It was also common ground that … the definition does catch the taxpayer's arrangement with the Mainland factories'. See CACV 45/2012 paragraph 10.

(e) Alternatively, the Appellant is entitled to depreciation allowances under sections 18F and 39B; by reason of the Commissioner's interpretation in paragraph 17 Departmental Interpretation and Practice Note ('DIPN') 15 in allowing depreciation allowances despite section 39E. He can only exclude other taxpayers from his own interpretation by legislative amendments, not by his own biased rules.

(f) The Commissioner has a duty to act fairly in terms of 64(2) as decided in Aviation Fuel Supply Appellant and CIR FACV 14 of 2013. This duty is not restricted only to act timely. Here he has failed this duty including, by (i) omitting facts and representations made to him; (ii) inconsistently and discriminately applying section 16G, section 39E and his practice in restricting change of opinion by assessors; (iii) revising assessing losses in 2015 which is about 11 years from 2003/04; (iv) asserting mistakes committed by assessors but failing to disclose any such finding; (v) failing to disclose the then assessing practices and (vi) ignoring adverse costing and cash flow planning of the Appellant in relying on assessed losses made by his assessors.

(g) There are unrelieved losses carried forward to set off against the assessable profits of the years of assessment 2006/07 and 2007/08. Firstly, there is no error committed by predecessor assessors at the relevant times. Secondly, it is wrong and unfair to correct them in 2015.

(h) The Commissioner's determination contains no finding of any relevant matters that the Appellant needed to prove but has failed to establish in discharging the burden of proof.

Undisputed Facts and Evidence

4. The Appellant agreed that the facts stated in the Determination were not disputed. Further the Appellant submitted no further evidence. The parties agreed that the documents annexed in the hearing bundles formed part of the evidence of the Appeal.

5. The following undisputed facts together with the agreed documents therefor formed the whole evidence of the Appeal:

(1) Company A ('the Appellant') has objected to the Profits Tax Assessment for the year of assessment 2006/07 and the Additional

Profits Tax Assessment for the year of assessment 2007/08 raised on it. The Appellant claims that it should be allowed deduction for the certain expenditure incurred on the purchase of moulds, as outgoings and expenses or as specified capital expenditure, in computing its assessable profits. The Appellant alternatively claims that it should be granted depreciation allowances on such expenditure.

(2) The Appellant is a private limited company incorporated in Hong Kong in 1978. The Appellant in the directors' reports described its principal activities as trading and design of toys. At all relevant times, the Appellant's business address was Address B.

(3) (a) The Appellant closed its annual accounts on 31 October.

(b) On divers dates, the Appellant furnished Profits Tax returns for the years of assessment 2003/04 to 2007/08 with supporting financial statements for the years ended 31 October 2003 to 2007 and tax computations.

(c) The Appellant in the return declared the following assessable profits or adjusted loss :

	2003/04	2004/2005	2005/06	2006/07	2007/08
Assessable Profits/ (adjusted loss)	($19,461,841)	$22,495	$2,695,978	$16,706,809	$75,003

(d) The declared assessable profits or adjusted loss were arrived at after deducting the following expenditure on moulds:

	2003/04	2004/2005	2005/06	2006/07	2007/08
Expenditure on Moulds ('the Expenditure')	$10,213,945	$9,688,420	$6,535,840	$4,020,850	$4,667,871

(e) In the Appellant's balance sheets as at 31 October 2003 to 2007, the moulds were classified as 'property, plant and equipment' under 'non-current assets'. The notes to financial statements stated that the estimated useful life of the moulds was 60 months from the start of production.

(f) The Company's financial statements were signed and confirmed by its directors.

(g) Copies of the Company's Profits Tax returns, supporting financial statements and tax computations for the years of assessment 2003/04 to 2007/08 were also submitted to the Commissioner for its consideration.

(4) (a) The Assessor in accordance with the declared assessable profits or adjusted loss issued to the Appellant the following statements of loss for the years of assessment 2003/04 to 2006/07 and Profits Tax Assessment for the year of assessment 2007/08;

Date of Issue	15-06-2004	20-05-2005	01-06-2006	30-05-2007	04-08-2009
Year of Assessment	2003/04	2004/05	2005/06	2006/07	2007/08
	$	$	$	$	$
Assessable Profits/ (Adjusted Loss)	(19,461,841)	22,495	2,695,978	16,706,809	75,003
Less: Loss set-off		22,495	2,695,978	16,706,809	36,559
Net Assessable Profits		0	0	0	38,444
Tax Payable thereon					1,681
Statement of Loss					
Loss brought forward	-	19,461,841	19,439,346	16,743,368	36,559
Adjusted Loss	19,461,841	-	-	-	-
Less: Loss set-off	-	22,495	2,695,978	16,706,809	36,559
Loss carried forward	19,461,841	19,439,346	16,743,368	36,559	0

(b) The 2007/08 Profits Tax Assessment bore the Assessor's note 'section 16G deduction allowed subject to review'

(5) By letters dated 17 January 2008 and 24 March 2009, the Assessor asked the Appellant to supply information on the Expenditure for the year of assessment 2006/07. The Appellant, or through Company C, provided the following information:

(a) The Appellant was a trader of toys with annual turnover of around $300 million. The Appellant made samples of toys to procure trading orders and engaged contractors to produce toys to fulfil the contracts. The Appellant provided moulds to the contractors and the contractors used the moulds to manufacture toys.

(b) The Appellant acquired moulds from vendors who had factories in Mainland China. The mould vendors produced the moulds in Mainland China and delivered the moulds to the contractors'

factories in Mainland China. The moulds were placed in the contractors' factories situated in Mainland China.

(c) The moulds acquired in the year of assessment 2006/07 in the total amount of $4,020,850 were placed in the following factories:

Name of factory	Location (City in Mainland China)
Factory D	City N
Factory E	City N
Factory F	City P
Factory G	City N
Factory H	City Q
Factory J	City N
Factory K	City N
Factory L	City R
Factory M	City P

(6) The Appellant, though Messrs C B Wong & Co ('the Representative'), provided the following further information and documents:

(a) Manufacturer's Agreement dated 14 October 2000 entered into between the Appellant and Company S. The agreement contained the following terms:

(i) The products manufactured by Company S were proprietary toy items designed by or for the Appellant. (Preamble)

(ii) Company S only manufactured the products to the order of the Appellant. (Clause 2)

(iii) Company S would not without the prior written consent of the Appellant, manufacture merchandise or products utilizing any of the copyrighted material. (Clause 4)

(iv) Company S would, upon the Appellant's request, immediately returned to the Appellant all moulds provided to it. (Clause 5)

(b) Contract No.XXX/XXXX dated 13 March 2009 by which the Appellant purchased from Company T 7 sets of mould at a total cost of $200,000.

(c) Mould Delivery Authorization dated 2 June 2009 under reference number XX XXXXX by which the Appellant authorized Company

S to collect 7 sets of mould from Company T in District U.

(d) The Appellant's letter dated 3 June 2009 to Company S, which contained the following particulars:

'We refer to (the authorization form under reference no.XXXXXXX)…You are requested to confirm (whether all moulds) were received by you, these moulds are consigned to you and at all times, (the Appellant) is the sole owner of these moulds.

We remind you of the terms and conditions stipulated in the Manufacturer's Agreement signed between us.

You are not authorized to sub-contract any parts of our mould to any vendor without prior approval and authorization from us. Furthermore, your company is fully responsible for the maintenance of the mould.

Your company guarantees us that all our moulds deposited in your China plants can be transferred back to (the Appellant) at any time in Hong Kong upon our request, and would not hold up these moulds for whatever reasons.'

(7) (a) The Assessor considered that deduction or depreciation allowance should not be provided to the Appellant in respect of the Expenditure.

(b) To disallow deductions previously granted in respect of the Expenditure for the years of assessment 2003/04 to 2005/06, the following revised 2003/04 statement of loss and 2004/05 and 2005/06 Profits Tax Assessments should be issued to the Company:

	2003/04	2004/05	2005/06
	$	$	$
Profit/Loss per return [Paragraph 5(3)(c) herein]	(19,461,841)	22,495	2,695,978
Add: The Expenditure	10,213,945	9,688,420	6,535,840
Assessable Profits/(Adjusted Loss)	(9,247,896)	9,710,915	9,231,818
Less: Loss set-off		9,247,896	
Net Assessable Profits		463,019	
Statement of Loss			
Loss brought forward	-	9,247,896	

	2003/04	2004/05	2005/06
	$	$	$
Adjusted loss for the year	9,247,896	-	
Less: Loss set-off	-	9,247,896	
Loss carried forward	9,427,896	0	

(c) At the relevant time, the Assessor was statutorily barred from raising the 2004/05 and 2005/06 Profits Tax Assessments on the Appellant. The Assessor revised the loss carried forward for the years of assessment 2004/05 and 2005/06 [Paragraph 5(4)(a)] to nil.

(8) The Assessor raised on the Appellant the following 2006/07 Profits Tax Assessment and 2007/08 Additional Profits Tax Assessment:

		$
(a)	Year of Assessment 2006/07	
	(Date of issue: 18 March 2013)	
	Profit per return [Paragraph 5(3)(c)]	16,706,809
	Add: The Expenditure [Paragraph 5(3)(d)]	4,020,850
	Assessable Profits	20,727,659
	Tax Payable thereon	3,627,340
(b)	Year of Assessment 2007/08	
	(Date of issue: 18 April 2013)	
	Profit per return [Paragraph 5(3)(c)]	75,003
	Less: Profit previously assessed [Paragraph 5(4)]	38,444
	Additional Assessable Profits	36,559
	Additional Tax Payable thereon	1,600

(9) The Appellant, through the Representatives, objected to the 2006/07 Profits Tax Assessment and the 2007/08 Additional Profits Tax Assessment on the ground that the Assessments were incorrect and excessive.

(10) The Representatives supplied the following information and documents:

(a) Lists of moulds acquired for the years ended 31 October 2006 and 2007.

(b) Contract No.XXX/XXXX dated 28 February 2006 by which the Appellant purchased from Company V 4 sets of mould at a total cost of $230,000.

(c) Contract No. XXX/XXXX dated 5 March 2007 by which the Appellant purchased from Company V 8 sets of mould at a total cost of $240,000.

(d) An analysis for 10 moulds, which showed the respective sale amounts generated by the moulds during their useful life.

(e) The Appellant did not have any relationship in terms of shareholding with Company S. All the factories were unrelated to the Appellant. They were third party manufacturers.

(f) The Manufacture's Agreement submitted is applicable to the years of assessment 2003/04 to 2007/08. Company S was one of the contractors to which the Appellant provided moulds in the years of assessment 2003/04 to 2007/08.

(g) Company S collected the moulds from Company T in District U and delivered them to Factory W. Company S produced toys for the Appellant in its factory at Factory W.

(h) The Appellant's operation were as follows:

(i) The Appellant secured purchase orders of toys from customers.

(ii) The Appellant engaged mould vendors such as Company T and Company V to build the moulds.

(iii) The Appellant authorized the manufacturers of toys to collect moulds form the mould vendors.

(iv) The manufacturers such as Company S used the moulds to produce toys for the Appellant.

(v) The manufacturers collected the moulds from the mould vendors' factory in Mainland China and delivered them to the manufacturers' factories in Mainland China.

(i) The description of the Company's operation in Paragraph 5(10)(h) is applicable to the years of assessment 2003/04 to 2007/08.

(j) The Appellant could sue the contractors/manufacturers for unauthorized use of the Appellant's moulds if the contractors used the moulds to produce toys for persons other than the Appellant.

(k) The Appellant did not have business registration certificate or tax registration certificate in Mainland China in the years of assessment 2003/04 to 2007/08.

(11) The Representatives put forth the following contentions:

Deduction of the Expenditure under section 16(1) of the Inland Revenue Ordinance ('the Ordinance')

(a) '*Toys are fashionable. Each design of a specific toy will require the designs of various toy parts. Each slight variation in such design will incur expenses on moulds and hence the recurring expenditure on moulds as recorded in (the Appellant's) account month after month; and year after year. Therefore, the expenses on moulds are part and parcel of the trading expenses and the costs of sales in fulfilling the trading contracts. They are not capital expenditure which would add to the permanent "structure" and enlarge the fixed asset base of (the Appellant's) business. From commercial perspective, these expenses are not capital expenditure incurred "once and for all" for the enduring benefits of the trade; as suggested under the classic test between capital expenditure and revenue expenditure.*'

(b) '*(Applying the legal propositions in Mallet v. Staveley Coal & Iron Co. Ltd. 13 TC 772 and B.P. Australia Ltd. v. Commissioners of Taxation of the Commonwealth of Australia [1965] 112 CLR 386), from (the Appellant's) practical and business point of view and with due regard to the "whole picture" of its business operations and common sense, the expenses incurred on moulds are recurring and were paid over and over in the course of its business operation as a trader of toys rather than a manufacturer of making toys. The expenses on moulds are part of the constant demand which must be answered out of the return of the trade. The expenses on moulds were just on the forefront of (the Appellant's) selling costs. The costs of moulds is closely tied to its day to day business operations rather than tied to any enlargement of its capital structure*'.

(c) '*The assessor should adopt a business sense appreciation of all the guiding features in the context of the Appellant's business (which is trading [not manufacturing] company in toys) including the followings:*

(i) The expenditure on the moulds is recurring every year.

(ii) Old toys are replaced by new toys. New toys require new moulds.

(iii) The moulds incurred for the specific toys are just part of the total costs of such toys sold. They are directly tied to the sales rather than tied to any enlargement of the capital structure of (the Appellant's) business.

(iv) The Appellant sells more toys when they are new in design; then their demands decrease; so does the effectively useful life of their moulds which is short. The moulds have no practical resale value.'

(d) '*The assessor wrongly ignored that (a) Nice Cheer Investment Ltd v CIR FACV23/2012 has held that the presentation of the accounts does not override legal principles; (b) The useful life of an asset of three to fifteen does not prevent it to be revenue expenditure, as held in B.P. Australia Ltd v Commissioners of Taxation of the Commonwealth of Australia [1965] 112 CLR 386; and (c) the Inland Revenue Rule ("IRR") 2 only applies to items already found to be capital assets in the first place.*'

Deduction of the Expenditure under section 16G of the Ordinance

(e) '*The arrangements between (the Appellant) and the contractors are arrangements between a principal and the agents; rather than in the nature of a lessor and lessees as intended to be included in the definition in section 2 of the IRO. Under the arrangement, (the Appellant) appointed the agents to process the toys according to (the Appellant's) instructions and on its accounts; the moulds were provided to the contractors to fulfil (the Appellant's) job orders; rather than granting "a right to use" (the moulds) freely outside (the Appellant's) job orders. As a matter of fact, and of law, there is no 'lease' of any moulds; whether within the legal meaning of the word "lease" of its extended meaning.*'

(f) '*The legal position is the same as an employee being allowed to use the employer's computer as an agent. IRD has not denied that in such circumstances, there is no "lease" of the computer between the employer and the employee that makes the computer an excluded asset. The same legal position is applicable to the relationship between the Appellant and its manufacturers. Such relationship does not depend on any written agreement. The Appellant does not have any written agency agreement in respect*

of the grant of right to use the moulds and of its copyrighted materials.'

(g) '*…(the Appellant) has never granted any rights to use of its moulds to the agents (the contractors). …(the Appellant's) agents never claimed that they were granted 'a right to use' the moulds. (The Appellant) has no loss of any legal rights in controlling the use of moulds throughout the period when the agents used the mould to process (the Appellant's) job orders. They just used the moulds on behalf of (the Appellant). Factually, the arrangement therefore does not fall within the extended definitions of a "lease".*'

(h) '*The assessor wrongly assumed that a mere use of the asset by a person other than the owner will satisfy the meaning of using the asset by way of "rights as a lessee under a lease." This is against the court's judgment at paragraph 10 of decision in Braitrim (Far East) Limited and CIR, CACV 45/2012; where it was observed that "on the undisputed evidence, and as the Board found, they were the subject of an arrangement under which a right to use the moulds was granted by the Taxpayer to the Mainland manufacturers, and thus were the subject of a lease as defined in section 2(1) of the Ordinance".*'

Depreciation allowance on the Expenditure

(i) '*Even assuming (which is denied) that the moulds were capital expenditure, such expenditure will rank for depreciation allowances under section 18F.*'

(j) '*It has been part of the foundation of the Hong Kong tax regime in that capital expenditure on plant and machinery is not deductible under section 17 but they are granted depreciation allowance under section 18F, "to the extent they were used in the production of assessable profits" – which is the only requirement for the allowances. There is no requirement under section 18F that such assets must be used in Hong Kong or to be physically used by a taxpayer. "Use" would include the use by employee, contractor or agent of the taxpayer.*'

(k) '*Section 39E is a specific anti-avoidance provision to counter-act specific tax avoidance situation … It is wrong … to extend its application to inhibit normal commercial transaction … There is no suggestion that the Legislative Council has enacted section 39E to limit the application of the long existed section 18F by*

requiring that the assets must be principally used in Hong Kong in order to claim depreciation allowances.'

Change of opinion by the Assessor

(l) '*It is unreasonable to re-open the tax treatment of the expenses on moulds already accepted before 2006/07; which is not the perceived intention of your predecessor to over-turn the accepted claims…*'

(m) '*IRD has a gracious declared policy (or concession) of general application as against disturbing past decision of (Assessors).*'

(n) '*…similar assurance has been given by IRD to (Hong Kong Institute of Certified Public Accountants)…, to restrict the approval of changed opinion by different assessor only to rare situations. … In the present case, there is no decided case on the interpretation of the word "lease" at the time when the assessors accepted the claims on moulds before 2006/07 and there is evidence to assert that any gross error in law had been committed by the various assessors during the long period of time in accepting (the Appellant's) claims.*'

(o) '*The practices as against changed opinion … are consistent with the underlying spirit of section 60 and section 70A of the (IRO) when read together, as against disturbing original opinion made by assessors under prevailing practices. Section 60(3) says that "No assessment shall be made under subsection (2) if the repayment was in fact made on the basis of, or in accordance with, the practice generally prevailing at the time when the repayment was made." Thus, even as assessor "wrongly" refunded tax on the basis of the practice generally prevailing, no additional assessment can be made under section 60. On the same footing, where a taxpayer wrongly offered for assessments non-taxable items or failed to claim deductible items, no error or omission can be claimed by invoking section 70A, as section 70A(1) says, "… no correction shall be made to any assessment in respect of an error or omission in any return or statement submitted in respect thereof as to the basis on which the liability to tax ought to have been computed where the return or statement was in fact made on the basis of or in accordance with the practice generally prevailing at the time when the return or statement was made." '*

(12) The Assessor now considers that the 2007/08 Additional Profits Tax Assessment should be revised as follows:

	$
Profit per return [Paragraph 5(3)(c)]	75,003
Add: The Expenditure [Paragraph 5(3)(d)]	4,667,871
Revised Assessable Profits	4,742,874
Less: Profits previously assessed [Paragraph 5(4)]	38,444
Revised Additional Assessable Profits	4,704,430
Revised Additional Tax Payable thereon	803,321

(13) All the documents referred to in this Paragraph forms part of the agreement documents which are annexed in the hearing bundle.

6. In the course of making submission, the Appellant strongly argued that the Respondent failed to provide any internal or public documents, or to make known to the assessors or the public which suggested that the past assessing practice or interpretation of 'lease' is 'a person was allowed to use the assets by the owner would suffice'. The Respondent confirmed that there was no such internal or public document in existence. The Appellant could not produce any such document to support its argument. At the end of the day, the Appellant conceded that no such document is in existence.

Relevant Legal Principles

7. The parties referred the Board to the following sections of the Inland Revenue Ordinance ('Ordinance') in the course of their respective submission:

(a) Section 2 defines '*lease*', in relation to any machinery or plant, to include '*any arrangement under which a right to use the machinery or plant is granted by the owner of machinery or plant to another person*' and '*arrangement*' to include '*any agreement, arrangement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable, or intended to be enforceable by legal proceedings*' and '*any scheme, plan, proposal, action or course of action or course of conduct*'.

(b) Rule 2 of the Inland Revenue Rules stipulates that '*For the purpose of the Ordinance, the expression "machinery or plant" shall include or be deemed to include the items specified in the second column of the First Part of the Table annexed to this rule*'. Item 26 of the First Part of the Table refers to '*Plastic manufacturing machinery and plant including moulds*'.

(c) Section 16(1) provides that, in ascertaining the profits in respect of which a person is chargeable to tax, there shall be deducted all outgoings and expenses to the extent to which they are incurred in the production of

chargeable profits, including payments and expenditure specified in section 16G.

(d) Section 15(1)(b) provides that '*sums, not otherwise chargeable to tax under this Part, received by or accrued to a person for the use of or right to use in Hong Kong any patent, design, trade mark…*'.

(e) (i) Section 16G provides that, in ascertaining the profits in respect of which a person is chargeable to tax, there shall be deducted any specified capital expenditure incurred by the person.

(ii) Section 16G(6) defines '*specified capital expenditure*' to mean '*any capital expenditure incurred by the person on the provision of a prescribed fixed asset*' and stipulated '*prescribed fixed asset … does not include an excluded fixed asset*'. '*Excluded fixed asset*' is defined to mean '*a fixed asset in which any person holds rights as a lessee under a lease*'.

(f) Section 17(1)(c) provides that no deduction shall be allowed in respect of any expenditure of a capital nature.

(g) Section 18F(1) provided that the amount of assessable profits for any year of assessment of a person shall be decreased by the allowances made to that person under Part 6 (which include depreciation allowance for machinery and plant) to the extent to which the relevant assets are used in the production of the assessable profits.

(h) Section 39B provides that initial and annual allowances, as appropriate shall be made to a person who incurs capital expenditure on the provision of machinery or plant for the purposes of producing profits chargeable to tax.

(i) Section 39E denies the making of initial or annual allowances to a taxpayer if, at a time when the relevant machinery or plant is owned by the taxpayer, a person holds rights as lessee under a lease of the machinery or plant which is used wholly or principally outside Hong Kong by a person other than the taxpayer.

(j) Section 60(1) provides that 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 ought to have been assessed.

8. The parties also submitted a number of court judgments and Board of Review decisions in support their respective arguments. Where such cases are appropriate and relevant, the Board will refer to them in the discussion hereinafter appearing.

Discussion

Ground 1: The assessments are incorrect or excessive.

9. This is a general ground. Depending on the outcome of the other grounds, the assessments may be incorrect or excessive. However, the assessments may not necessarily be incorrect or excessive even if it is successful on a ground which is not related to assessment but on legal principle not related to assessment. The Board will come to discuss this ground after the Board has considered each and every other ground of Appeal.

Ground 2: Expenditure on moulds ('Expenditure') is deductible under section 16(1)

10. It is argued by the Appellant that it incurred substantial sums on the Expenditure yearly; not once for all. The Appellant submitted that (a) the effective useful life of the moulds is estimated to be five years; (b) the specific moulds are used for specific category of toys; (c) expenditure on new moulds is incurred for new toys which is recurring year after year; not once and for all; (d) the expenditure can be identified to the cost of sale of the specific toys sold; (e) the Appellant sells more toys when they are new in design; then their demands decrease; so does the effective useful life of the moulds; and (f) no copyrighted materials have been licensed to the manufacturer under the Manufacturer Agreement.

11. The Appellant submitted that the issue of a revenue or capital expenditure should be decided by a common sense appreciation of the Expenditure in the context of the Appellant's operations [B P Australia Ltd v The Commissioner of Taxation of the Commonwealth of Australia [1965] 3 All E R 209]. The accounts or the useful life of the expenditure are not the deciding considerations.

12. The Appellant also submitted that the notes or description stated in the financial statements or audited accounts on 'expenditure' should not be a deciding factor in interpreting whether the nature of the expenditure is revenue or capital in nature. The Appellant referred the Board to the observation of Lord Denning which was quoted in Nice Cheer Investment Ltd v CIR [FACV 23/2012]:

> '*The courts have always been assisted greatly by the evidence of accountants. Their practice should be given due weight. But the courts have never regarded themselves as being bound by it. It would be wrong to do so. The question of what is capital and what is revenue is a question of law for the courts. They are not to be deflected from their true course by the evidence of accountants, however eminent.*'

13. In reply, the Respondent submitted that throughout the years, the financial statements of the Appellant invariably stated that the estimated useful life of the moulds was 60 months and the expenditure was classified as 'property, plant and equipment' under 'non-current assets'. Further the Appellant claimed such expenditure in its Profits Tax Return as expenditure on machinery and plant. The Respondent also referred the Board to the accounting policies for plant and machinery provided in the Appellant's reports and financial statements where it was mentioned 'when assets are sold or retired, their cost and aggregate depreciation and accumulated impairment losses are removed from the financial statements and any gain or loss resulting from their disposal is included in the income statement'. The Respondent further argued that the reports and financial statements did not reveal any disposal of moulds save for the year of assessment 2006/07 which was $45,500 only (which was minimal compared with the amount of additions over the years). Therefore, the Respondent argued that in the Appellant's own words, the Expenditure must be capital, instead of revenue in nature.

14. The Respondent made further submission on its reply to this ground that if the Appellant wished to challenge its own audited financial statements and tax declaration made by a director, it is not sufficient merely to say that either a mistake was made or that the accounts were kept in a particular form which was incorrect 'for convenience'. In this connection, the Respondent referred the Board to the guiding principle made by the Court of Appeal in Chinachem Investment Co Ltd v CIR [1987] 2 HKTC 261.

15. The Board accepts the guiding principles referred to in the above. If the Board accepts such guiding principles, it should apply the same on the facts found by the Board. There were no evidence submitted by the Appellant to substantiate its arguments under paragraph 10 above. The evidence before the Board is that for the past years, the Appellant treated the Expenditure as a capital expenditure. If the Appellant wished to challenge that there were mistakes in its financial statements and declarations made by a director, it should substantiate such mistakes by unequivocal evidence. Unfortunately, the Appellant submitted none. There was no evidence for the Board to consider by using a common sense as proposed by the Appellant. In the circumstances, the only logical conclusion made by the Board is that the Expenditure is a capital expenditure.

Ground 3 and Ground 4: The moulds are deductible under section 16G of the Ordinance. The Commissioner has gone far by asserting that Braitrim (Far East) Limited v CIR has decided that the arrangement under which the taxpayer allowed the manufacture in Mainland China to use moulds to produce the taxpayer's products fell within the definition of a lease.

16. It is common ground that the Expenditure (of a capital nature) is deductible under section 16(1) of the Ordinance unless it is an excluded asset under section 16G of the Ordinance. Under Section 16G of the Ordinance, an excluded fixed asset means a fixed asset in which any person hold rights as a lessee under a lease. The lease is defined in Section 2 as: '*lease, in relation to any machinery or plant, includes – (a) any arrangement under which a right to use the machinery or plant is granted by the owner of the machinery*

or plant to another person; and (b) any arrangement under which a right to use the machinery or plant, being a right derived directly or indirectly from a right referred to in paragraph (a), is granted by a person to another person, but does not include a hire-purchase agreement or a conditional sale agreement unless, …'.

17. The issue is therefore whether there was an arrangement or agreement under which a right to use the machinery or plant was granted by the Appellant (being owner of the moulds) to another person. If there was such an arrangement or agreement, the moulds were excluded assets. On the other hand, if there was no such arrangement, the moulds were not excluded asset.

18. The Appellant strenuously argued that (a) a person being allowed to use the asset of the owner is not sufficient evidence to conclude that his use is derived directly or indirectly from the grant of 'a right to use'; (b) it is not necessary to consider the relationship between the parties in deciding whether 'a right to use' has been granted or not; whether an employee, agent or a related party or an independent contractor. The definition does not require such consideration; and (c) it is the evidence for the grant of a right to use which decides whether the arrangement falls into the definition. The evidence is the agreement between the contracting parties.

19. It should be noted that the aforesaid arguments were made with no reference to evidence of the case.

20. The undisputed arrangement between the Appellant and its manufacturers relating to the use of the mould owned by the Appellant to manufacture toys for the Appellant is that (a) the Appellant secured purchase orders of toys from customers; (b) the Appellant engaged mould vendors to build the moulds; (c) the Appellant authorized the manufacturers of toys to collect moulds from the mould vendors; and (d) the manufacturers used the moulds to produce toys for the Company. [Paragraph 5(5) and Paragraph 5(10)(h)].

21. The Appellant referred the Board to Braitrim (Far East) Limited v CIR [2013] 4 HKLRD 329. Braitrim was a supplier of plastic garment hangers and related packaging materials. The hangers were manufactured by one of two factories unrelated to Braitrim or its parent company. The hangers were manufactured using moulds provided by Braitrim. The moulds were property of the Braitrim. The aforesaid arrangement was held by the Court of Appeal that it constituted a lease between Braitrim and the manufacturers in respect of the moulds, which falls within the meaning of 'lease' under section 2(1) of the Ordinance.

22. Based on the undisputed facts of the present case, the Board found that the arrangement of the using of moulds between the Appellant and its manufacturers was substantially similar, if not identical, to the arrangement of Braitrim's case. As such, the Board found that there was a lease within the meaning of section 2 of the Ordinance between the Appellant and its manufacturers on the moulds concerned and the Expenditure (being held as a capital nature) is an excluded fixed asset. It follows that the Expenditure is not deductible under section 16(G) of the Ordinance.

Ground 5: The Appellant is entitled to depreciation allowances under sections 18F and 39B by reason of the Commissioner's interpretation in paragraph 17 of Departmental Interpretation and Practice Note 15.

23. In arguing that the Appellant is entitled to depreciation allowances under sections 18F and 39B by reason of DIPN No.15, the Appellant referred the Board to the following:

> Paragraph 19: '*Under a contract processing arrangement with a Mainland Chinese enterprise, a Hong Kong company is often required to provide machinery or plant for the use of the Mainland Chinese enterprise. Such arrangement is a lease as defined in section 2 (see paragraph 9) and therefore section 39E needs to be considered. Even though the machinery or plant is not used wholly or principally in Hong Kong, the Department as a concession is prepared to allow 50 percent of the depreciation allowances on the leased machinery or plant on the condition that the profits from manufacturing activities of the Hong Kong company are assessed on a 50:50 basis.*'

24. The Appellant also referred the Board to the summary of the 2007 Annual Meeting between the Commissioner and the HKICPA when the Commissioner stated that:

> 'The issue was to be resolved by considering two factors – whether the plant and machinery were owned by the Hong Kong entity and whether they were used in the production of its profits chargeable to tax under the IRO. …Ms Macpherson pointed out that import processors incurred substantial costs on plant and machinery and the Mainland enterprise was in effect the manufacturer's agent producing goods for the Hong Kong entity, CIR said if, in a particular case, the two factors applied, then the matter could be considered further.'

25. The Appellant submitted that the Appellant owned the moulds and they were used in the production of its assessable profits; same as in contract processing arrangement. There are no complicated issues not to grant similar concession.

26. It would appear that this argument was sound if the arrangement of the using of the moulds by the Appellant's manufacturers in the mainland was based on contract processing agreements with its mainland Chinese manufacturers. Such contract processing agreements necessitate the formal approval by the relevant authorities in the Mainland China before the moulds could be imported to the mainland on a tax concessionary basis for the manufacturing of the Appellant's goods. From the undisputed facts of the case, it is difficult to find any evidence that such use of the moulds by the manufacturers in the mainland was by way of contract processing agreements. Neither did the Appellant submit any evidence to substantiate there were contract processing arrangement between the Appellant and its mainland manufacturers by way of production of the necessary approval

certificates or otherwise.

27. Since the use of the moulds by the mainland manufacturers were not based on contract processing arrangement, there was no substances whatsoever on this ground.

Ground 6*: *The Commissioner has a duty to act fairly in terms of section 64(2) of the Ordinance as decided in Aviation Fuel Supply Company v CIR

28. To elaborate further this ground, the Appellant submitted that the duty of the Commissioner was not restricted only to act timely. The Commissioner failed this duty including, by (i) omitting facts and representations made to him; (ii) inconsistently and discriminatively supplying section 16G, section 39E and his practice in restricting change of opinion by assessors; (iii) revising assessed losses in 2015 which is about 11 years from 2003/04; (iv) asserting mistakes committed by assessors but failing to disclose any such finding; (v) failing to disclose the then assessing practices and (vi) ignoring adverse costing and cash flow planning of the Appellant in relying on assessed losses made by his assessors.

29. To argue that it is unfair to re-open back year assessment outside the limitation, the Appellant referred the Board to Aviation Fuel Supply Company v CIR, FACV No.14 of 2013. The Appellant specifically referred the Board to paragraphs 20, 24, 25 and 27 of the judgment. On a close look on these paragraphs, it is not difficult to find out that it is a decision on the re-opening of assessment at the stage of an appeal (by amending the Notice of Appeal) against a decision of the Court of Instance made under section 67 of the Ordinance. In the Board's view, this case is irrelevant when the Appellant did not dispute that under section 60 of the Ordinance the assessor has the power to make re-assessment within the year of assessment or within 6 years after the expiration thereof, if any person chargeable with tax has not been assessed or has been assessed at less than the proper amount by the assessor.

30. The Appellant also referred the Board to CIR v Common Empire [CA No.83 of 2006] ('Common Empire'). Based on the decision of Common Empire, the Appellant argued that the statement of loss for 2004/05 to 2006/07 were administrative documents, not issued under any specific sections in the Ordinance. They showed the balance of the unrelieved loss of 2003/04 after setting off the assessable profits for 2004/05 to 2006/07. They did not mean that they were the computations of loss for the years of assessment 2004/05 to 2006/07 themselves. The Appellant submitted that there were no losses for 2004/05 to 2006/07 that could be adjusted under the principle of Common Empire.

31. As decided in Common Empire, Appeal Justice Rogers VP said in paragraph 9:

> '*there is no statutory reference to a "statement of loss". A statement of loss is simply an administrative document which has no statutory force. Under s.19C of the Ordinance a person who sustains a loss in any trade, profession or business can have the amount of that loss carried forward and set off against*

> *the amount of his assessable profits from that trade, profession or business for subsequent years of assessment. …'*

32. Regarding the Appellant's submission that there were no losses for 2004/05 to 2006/07 that can be adjusted, the Respondent submitted that the Appellant did not take issue on the revision of statements of loss in the years of assessment from 2003/04 to 2005/06 in the Notice of Appeal. By reason of section 66 of the Ordinance the Respondent argued that the Appellant was barred from running this argument before the Board because they did not form part of the grounds of appeal.

33. Under section 66, so long as the Board gives leave to the Appellant to argue any point not on the Notice of Appeal, the Appellant can argue the points not so specified in the Notice of Appeal. However, the Board does not feel that it is an appropriate case that leave should be given to the Appellant because Common Empire does not assist the Appellant's argument. According to Common Empire, the statement of loss is an administrative document which has no statutory force and hence is not subject to any limitation of time. In other words, the statement of loss can be adjusted anytime as and when there is justification to do so.

34. Regarding point (i) of Ground 6, the Appellant did not identify any facts and representations made to the Commissioner which he omitted in his decision. On reading the agreed papers, the Board did not find that there was any material facts or representations made by the Appellant, which the Commissioner did not consider and purposely omit in the Determination.

35. Regarding point (ii) of Ground 6 that the Commissioner has inconsistently and discriminatively apply section 16G, section 39E and his practice in restricting change of opinion by assessors, the Board agreed with the Respondent's submission that the law concerning lease of moulds was not certain before the decision of Braitrim and before then, the Commissioner made assessment in this regard on a case by case basis and there was not prevailing practice at the time. Once the point of 'lease' was settled by Braitrim, the Commissioner applied Braitrim consistently on cases involving 'lease' of the assets.

36. The Appellant also alleged that it has a 'legitimate expectation' that the Commissioner will adhere to his assessing practices and apply them in a fair and rational manner; rather than abusing such power to provide benefits only to selected taxpayers. However, the Appellant confirmed in the beginning that there was no internal or public document issued by the Respondent regarding the past assessing practice or interpretation of 'lease' being 'a person was allowed to use the assets by the owner would suffice' in existence. In the absence of any policy or guideline promulgated by the Respondent, the Board feels that the Appellant did not establish what was the 'legitimate expectation' referred to in its argument. As such there is absolute nothing to support the argument of the Appellant having a 'legitimate expectation' that the Commissioner will adhere to his assessing practices and apply them in a fair and rational manner. This argument of 'legitimate expectation' should fail.

37. Regarding the rest of the points of the Ground 6, the Board did not find that there was anything which had substance to support the points.

Ground 7: There are unrelieved losses carried forward to set off against the assessable profits of the years of assessment 2006/07 and 2007/08.

38. As decided in the previous paragraphs that the Appellant did not take issue with statement of losses for 2004/05 to 2006/07 which had been set off against the assessments of profit for the relevant years (to nil), it was wrong for the Appellant to argue that there are unrelieved losses carried forward to set off against the assessable profits of the years of assessment 2006/07 and 2007/08.

Ground 8: The Commissioner's determination contains no finding of any relevant matters that the Company needed to prove but has failed to establish in discharging the burden of proof.

39. On reading the Commissioner's Determination again, the Board finds that the Determination gives a clear account of all the facts, the arguments put forward by the Appellant and the relevant laws and decided cases he had duly considered. The Determination also sets out how the Commissioner applied the law on the facts he had considered. Under section 68 of the Ordinance, it is the duty of the Appellant to prove its case in the Appeal. The Commissioner has no such duty to prove its case or assist the Appellant to prove its case so long as he has properly set out the facts and the relevant laws he had considered and explained how he applied the laws on the facts he considered. In the circumstances, there is simply no substance in this ground.

40. Since the Appellant fails in Ground 2 to Ground 8, the general ground being Ground 1 has to be failed.

Conclusion

41. Since the Appellant fails to establish any ground of appeal, this Appeal must be dismissed and all assessments stated in paragraph 1 are hereby confirmed.

Costs

42. The above account shows that many of the grounds relied on by the Appellant were not 'arguable' at all and should not be put forward as grounds of appeal. Accordingly, the hearing was unnecessarily prolonged by such 'unarguable grounds'. It was a waste of time for every party. We find this to warrant a costs order against the Appellant. Pursuant to section 68(9) and Part 1 of Schedule 5 of the IRO, we order the Appellant to pay $5,000 as costs of the Board which shall be added to the tax charged and recovered therewith.