Case No. BR 29/69

Board of Review:

S. V. Gittins, Q.C., *Chairman*, F. E. Coles, K. I. Coullie and D. A. L. Wright, *Members.*

9th March 1970.

Profits tax—transfer of textile export quotas—whether amount paid on transfer an allowable deduction or expenditure of a capital nature—Inland Revenue Ordinance, sections 16(1) and 17(1)(*c*).

The appellant, a company, paid $272,074 to another company for the transfer from it to the appellant of certain textile export quotas. The quotas were required to enable the appellant to export textiles to the United Kingdom. The amount paid on the transfer was treated by the Assessor as capital expenditure in respect of which, for the purpose of ascertaining chargeable profits, no deduction is allowable under section 17(1)(*c*). On appeal.

Decision: Assessment appealed against confirmed.

D. A. S. Hart for the Appellant.

B. P. Clancy, Crown Counsel, for the Commissioner of Inland Revenue.

Cases referred to:—

1. B.P. Australia Ltd. v. Commissioner of Taxation for the Commonwealth of Australia, (1966) A.C. 260.
2. Regent Oil Co., Ltd. v. Strick, (1966) A.C. 295.
3. John Smith & Son v. Moore, (1921) A.C. 13.
4. Henricksen v. Grafton Hotel Ltd., 24 T.C. 453; (1942) 2 K.B. 184.
5. Income Tax Case No. 998, 25 S.A.T.C. 179.
6. Income Tax Case No. 1063, 27 S.A.T.C. 57.
7. New State Areas Ltd. v. Commissioner of Inland Revenue, S.A.L.R. (1946) A.D. 610.

Reasons:

The question on this appeal is whether $272,074 paid by the taxpayer for the acquisition of Cotton Textile Quotas from another company is capital expenditure or an allowable deduction.

Section 16(1) of *Cap.* 112 provides that in ascertaining the profits chargeable to tax, all outgoings and expenses to the extent to which they are incurred in the production of profits in respect of which the taxpayer is chargeable to tax for any period are deductible. This provision is subject *inter alia* to section 17(1)(*c*) which prohibits the deduction of any expenditure of a capital nature.

There are similar provisions in the taxation laws of the United Kingdom, Australia and South Africa.

Neither party has been able to cite any authority which is directly in point with the present case.

The Privy Council in **B.P. Australia Ltd. v. Commissioner of Taxation for the Commonwealth of Australia**[1], said that the result in that case depended on the weight and emphasis given to indisputable facts and the overall inference drawn from the situation as a whole. And at p. 264, the judgment stated :—

> "The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a commonsense appreciation of all the guiding features which must provide the ultimate answer. Although the categories of capital and income expenditure are distinct and easily ascertainable in obvious cases that lie far from the boundary, the line of distinction is often hard to draw in border line cases; and conflicting considerations may produce a situation where the answer turns on questions of emphasis and degree. That answer:
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> > 'depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured employed or exhausted in the process':
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> per Dixon J. in *Hallstroms Pty. Ltd. v. Federal Commissioner of Taxation.* As each new case comes to be argued felicitous phrases from earlier judgments are used in argument by one side and the other. But those phrases are not the deciding factor, nor are they of unlimited application. They merely crystallise particular factors which may incline the scale in a particular case after a balance of all the consideration has been taken".

In the **B.P.** case[1] it was held that the expenditure by the taxpayer to secure exclusive sale situations, on a balance of all the relevant considerations, was of a revenue and not of a capital nature. **In Regent Oil Co., Ltd. v. Strick**[2], the House of Lords held that expenditure

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[1] (1966) A.C. 260.
[2] (1966) A.C. 295.

in a different manner but for the same purpose was capital expenditure. The Court in the **Regent Oil** case[2] was comprised of the identical law lords as in the **B.P.** case[1], the judgments were delivered on the same day but no reference was made to the other decision by either body!

John Smith & Son v. Moore[3] was cited in support of the case for the Commissioner. In the **B.P.** case[1] the Court commented on that case—"one certainly cannot deduce that the result would have been the same if the son had paid £30,000 to the collieries for the contract". It was suggested in the course of the arguments before us that a possible inference from those words could be that if the taxpayer in that case was already in business and purchased the benefit of the contracts from third parties, the purchase price would have been deductible as a trading expense. We do not feel, however, that such an inconclusive comment is very helpful in deciding the particular issue before us.

It appeared to the Board that a helpful U.K. case is **Henricksen v. Grafton Hotel Ltd.**[4], if an analogy can properly be drawn between payments for the monopoly value in respect of a liquor licence and the payments by the Hong Kong taxpayer to acquire the quotas to secure entitlements to seal textiles in the U.K. thereunder. In the **Grafton Hotel** case[4] the Court of Appeal held that those payments were capital payments although paid by instalments. However, in the **Regent Oil case**[2] at p. 343, Lord Upjohn said that he regarded the decision in the **Grafton Hotel** case[4]—"as a very special case, a decision which if it can be supported at all can be justified solely upon its own particular facts within the ream of licensing laws".

Two South African cases were cited to the Board, viz. No. 998 reported in 25 S.A.T.C. 179 and No. 1063 reported in 27 S.A.T.C. 57. We see some similarity between the facts in those cases and the case before this Board. The first case concerned the price paid by the taxpayer for the interests of other parties in certain sales contracts. In the second case the taxpayer paid a sum for the exclusive right to become the sole agent of the payee. In both cases the expenditures were held to be of a capital nature. Both these cases were decisions of a court inferior to the Supreme Courts and High Courts and would appear only to be of persuasive authority at best.

In the South African Case No. 1063 the Court cited **New State Areas Ltd. v. Commissioner of Inland Revenue**[7], which contrasted expenditure incurred for the purpose of acquiring a capital asset with expenditure which if it was "part of the cost incidental to the performance of the income producing operations, as distinguished from the equipment of the income producing machine, then it is a revenue expenditure even if it is paid in a lump sum". It is to be noted that the same part of the judgment in that case was referred to by Lord Morris in his judgment in the **Regent Oil** case[2] at p. 329 and gives additional weight to the South African decision.

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[2] (1966) A.C. 295.
[3] (1921) A.C. 13.
[4] 24 T.C. 453; (1942) 2 K.B. 184.
[7] S.A.L.R. (1946) A.D. 610.

This test or principle was applied in Case No. 1063. The Court held that if the taxpayer company had not acquired the franchise, it would not have been able to commence trading in that special line of goods. By paying for the franchise a source of profit was acquired and the company could commence to trade and endeavour to earn profits, but until the source of profit had been acquired it could not do so. Therefore it was held that the expenditure was for the purpose of acquiring a capital asset.

The Board is of the view that this approach is the appropriate one for the determination of the question in the case before it.

The taxpayer paid $272,074 to purchase the textile quotas. Without the quotas it could not commence trade by selling in the U.K. (If the taxpayer had other quotas, then it could not trade beyond those quotas, until the quotas in question had been acquired).

The tax deductible cost of the income producing operations of the taxpayer would not commence until after the acquisition of the quotas which latter was therefore the acquisition of a capital asset.

Having found that the expenditure was capital and therefore caught by section 17(1)(*c*), it follows that the taxpayer has not discharged the onus placed on it by section 68(4) to prove that the assessment appealed against is excessive or incorrect.

The appeal is therefore dismissed and the assessment appealed against is confirmed.

Although principles of equity have little place in the law of taxation, the Board notes that the Commissioner’s circular letter dated 29th July, addressed to all practicing accountants gave notice of his intention to assess payments for permanent transfers of quotas in the manner appealed against. The taxpayer could not have been taken by surprise and must have entered into the quota transfer contract with the knowledge that in the Commissioner’s view at least it would not be deductible as a trading expenses.