

**Case No. D18/11**

**Profits tax** – deductions – prescribed fixed assets – excluded fixed assets – plastic moulds used by another company at the permission of the Taxpayer – whether the permission amounted to a lease of the plastic moulds under the Inland Revenue Ordinance ('IRO') – sections 2, 16, 16G and 17 of the IRO.

Panel: Colin Cohen (chairman), Arthur McInnis and Ng Man Sang Alan.

Date of hearing: 28 June 2011.

Date of decision: 23 August 2011.

The Taxpayer engaged in the supply of plastic products and packaging materials, mass-produced from moulds manufactured by another company, Company C. The Taxpayer permitted Company C to use the moulds for the latter's production of the plastic products on the Taxpayer's behalf. The moulds were kept by Company C for the Taxpayer. In the material years of assessment, the Taxpayer claimed capital expenditure deductions of the cost of producing the moulds, treating the same as prescribed fixed assets. The Taxpayer also claimed deductions for royalty income received, arguing they were earned offshore. The Assessor, except to allow deductions of the proceeds on disposal of the moulds, rejected the claim for deductions and raised additional assessments. The Taxpayer refused to accept the revised additional assessment raised by the Assessor. The claim for deduction of the royalty income was subsequently withdrawn by the Taxpayer.

**Held:**

1. Section 17 of the IRO provides that no deduction shall be made for capital expenditure for the purpose of calculating the assessable profits under section 16. This is subject to the provisions of section 16G, which allows deduction for any specified capital expenditure incurred on any prescribed fixed assets. There is no dispute that plastic moulds fall within prescribed fixed assets as defined under section 16G, provided that they are not excluded fixed assets. As defined in section 16G(6), excluded fixed assets means fixed assets in which any person holds rights as a lessee under a lease. Lease is defined in section 2 to include, in relation to any machinery or plant, any arrangement under which a right to use the same is granted by the owner.
2. The term 'lease' in section 16G(6) must be construed based on the meaning defined in section 2 of the IRO, but not on its ordinary or legal meaning as submitted by the Taxpayer. There is no basis to ignore the statutory definition of a 'lease' in the IRO because it is unequivocal and clear in

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

enlarging the ordinary meaning of the word by using ‘include’ in the interpretation clause (Dilworth v Commissioner of Stamps [1899] AC 99; Thomas v Marshall [1953] AC 543; Penny’s Bay Investment Co Ltd v Director of Lands FACV 8/2009, 26.03.2010 applied). This is so even though in practice it may be very difficult under any circumstances for any taxpayer to take advantage of the deductions.

3. Previous cases decided by the Board of Review has also construed the word ‘lease’ according to the statutory meaning rather than its ordinary and legal meaning (D61/08, (2009-10) IRBRD, vol 24, 184; D19/09, (2009-10) IRBRD, vol 24, 483 applied).
4. On the facts, it is not disputed that there is an arrangement under which a right to use the plastic moulds was granted by the Taxpayer to Company C. Thus, the plastic moulds were ‘excluded fixed assets’ within the definition of section 16G(6), and the capital expenditure incurred by the Taxpayer on the provision of the same fell outside section 16G.

**Appeal dismissed.**

Cases referred to:

Peterson v CIR [2005] STC 448 (PC)  
HKSAR v Cheung Kwun Yin (2009) 12 HKCFAR 565  
Medical Council of Hong Kong v Chow Siu Shek (2000) 3 HKCFAR 144  
Director of Lands v Yin Shuen Enterprises Ltd (2003) 6 HKCFAR 1  
PCCW-HKT Telephone Ltd v Telecommunications Authority (2005) 8 HKCFAR 337  
Dilworth v Commissioner of Stamps [1899] AC 99  
Thomas v Marshall [1953] AC 543 [(FACV 8/09, 26.3.2010)]  
Penny’s Bay Investment Co Ltd v Director of Lands  
D61/08, (2009-10) IRBRD, vol 24, 184  
D19/09, (2009-10) IRBRD, vol 24, 483

Barrie Barlow SC instructed by PricewaterhouseCoopers Limited for the Taxpayer.  
Eugene Fung Counsel instructed by Department of Justice, Fong Wai Hang Freda and Leung Wing Chi for the Commissioner of Inland Revenue.

**Decision:**

## Introduction

1. This is an appeal by Company A (Region B) Limited ('the Taxpayer') against the Acting Deputy Commissioner of Inland Revenue's determination dated 12 February 2010 ('the determination'). The determination was as follows:

- '(1) Additional Profits Tax assessment for the year of assessment 2000/01 under Charge Number X-XXXXXXX-XX-X, dated 29 March 2007, showing additional Assessable Profits of \$11,433,102 with additional Tax Payable thereon of HK\$1,829,296 is hereby increased to additional Assessable Profits of \$11,435,252 with additional Tax Payable thereon of \$1,829,640.
- (2) Additional Profits Tax assessment for the year of assessment 2001/02 under Charge Number X-XXXXXXX-XX-X, dated 10 January 2008, showing additional Assessable Profits of \$3,806,307 with additional Tax Payable thereon of HK\$609,010 is hereby reduced to additional Assessable Profits of \$3,377,865 with additional Tax Payable thereon of \$540,459.
- (3) Additional Profits Tax assessment for the year of assessment 2002/03 under Charge Number X-XXXXXXX-XX-X, dated 10 January 2008, showing additional Assessable Profits of \$4,810,332 with additional Tax Payable thereon of HK\$769,654 is hereby reduced to additional Assessable Profits of \$4,606,332 with additional Tax Payable thereon of \$737,014.'

2. On 10 March 2010, the Taxpayer's representatives, PricewaterhouseCoopers Limited ('the Tax Representatives') filed the following grounds of appeal:

- '1. The Commissioner erred in law in his construction of the relevant provisions of the IRO.
- 2. In particular, the Commissioner erred in law in his construction of "lease" under sections 2 and 16G of the IRO.
- 3. The Commissioner also erred in disregarding the fact that the underlying plant and machinery was used in the production of the Appellant's profits chargeable to profits tax.'

## Agreed facts

3. The following facts were agreed by the parties and we find them as facts:

- (1) The Taxpayer has objected to the additional profits tax assessments for the years of assessment 2000/01 to 2002/03 raised on it. The Taxpayer claims that it was entitled to deduction of expenditures on prescribed fixed assets in respect of the moulds used by its suppliers outside Hong Kong. The Taxpayer also claimed (but subsequently withdrew that claim) that the royalty income it received was offshore in nature.
- (2) The Taxpayer was incorporated in Hong Kong as a private company on 25 March 1988. In its profits tax returns, the Taxpayer declared its principal activity as 'supply of plastic [Product Y] and packaging materials'. The Taxpayer ceased its business on 1 July 2002.
- (3) In the profits tax returns for the years of assessment 2000/01 to 2002/03, supported by audited financial statements and profits tax computations for the period ended 30 June 2000 and for the years ended 30 June 2001 and 2002, the Taxpayer reported amongst other things the following profits, income and expenditure:

Year of assessment	<u>2000/01</u>	<u>2001/02</u>	<u>2002/03</u>
	\$	\$	\$
(a) Assessable profits	<u>33,457,609</u>	<u>59,113,981</u>	<u>43,037,506</u>
(b) Prescribed fixed assets – Moulds			
(i) Cost claimed as deductible	<u>11,082,700</u>	<u>3,292,183</u>	<u>4,270,470</u>
(ii) Sales proceeds offered for assessment	<u>0</u>	<u>517,500</u>	<u>204,000</u>
(c) Royalty income not chargeable to tax	<u>350,402</u>	<u>514,124</u>	<u>539,862</u>

In accordance with the assessable profits returned, the Assessor, in January and July 2003, raised on the Taxpayer profits tax assessments for the years of assessment 2000/01 to 2002/03. The Taxpayer did not object to these assessments.

- (4) Messrs Deloitte Touche Tohmatsu ('Deloitte'), the Taxpayer's former tax representative, provided, among others, copies of the following documents:
  - (a) Exclusive Product Y Supply Agreement with Company C [Deloitte asserted that Appendices A and B to this agreement could not be located due to the passage of time].
  - (b) Supply agreement with Company D.

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (c) An analysis of the moulds provided to the suppliers for the years of assessment 2000/01 to 2002/03.
  - (d) An analysis of the moulds used by Company C for the period from 4 January 1999 to 31 May 2002.
  - (e) Confirmation letter dated 8 June 2007 from Company C confirming that the moulds held by Company C belonged to the Taxpayer and that they were not treated as assets of Company C.
- (5) The Assessor was not satisfied that the expenditures on provision of moulds were deductible under section 16G of the Inland Revenue Ordinance or that the royalty income was derived outside Hong Kong. She raised, in March 2007 and January 2008, on the Taxpayer the following additional profits tax assessments for the years of assessment 2000/01 to 2002/03:

	<u>2000/01</u>	<u>2001/02</u>	<u>2002/03</u>
	\$	\$	\$
Profits per return	33,457,609	59,113,981	43,037,506
<u>Add:</u>			
Deduction of expenditure on moulds	11,082,700	3,292,183	4,270,470
Royalty income	<u>350,402</u>	<u>514,124</u>	<u>539,862</u>
Assessable profits	44,890,711	62,920,288	47,847,838
<u>Less:</u>			
Profits already assessed	<u>33,457,609</u>	<u>59,113,981</u>	<u>43,037,506</u>
Additional assessable profits	<u>11,433,102</u>	<u>3,806,307</u>	<u>4,810,332</u>
Additional tax payable thereon	<u>1,829,296</u>	<u>609,010</u>	<u>769,654</u>

- (6) On behalf of the Taxpayer, Deloitte objected to the additional profits tax assessments for the years of assessment 2000/01 to 2002/03 on the grounds that the royalty income was offshore in nature [this ground was subsequently withdrawn, see Fact (8) below] and that the Taxpayer should be entitled to 100% deduction for the moulds.
- (7) The Assessor maintained the view that the royalty income was sourced in Hong Kong and that the deduction of expenditure on prescribed fixed assets should not be allowed. The Assessor, however, was prepared to exclude the sale proceeds from disposal of moulds which were purchased by the Taxpayer in years of assessment 2000/01 and onwards where the expenditure claim for deduction under section 16G was denied. By a letter dated 22 May 2008, the Assessor proposed to revise the additional profits tax assessments for the years of assessment 2000/01 to 2002/03 as follows:

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

Year of assessment	<u>2000/01</u>	<u>2001/02</u>	<u>2002/03</u>
	\$	\$	\$
Profits per return	33,457,609	59,113,981	43,037,506
<u>Add:</u>			
Royalty income	350,402	514,124	539,862
Deduction of expenditure on moulds	11,082,700	3,292,183	4,270,470
Moulds included in cost of sales	<u>2,150<sup>1</sup></u>	<u>-</u>	<u>-</u>
	44,892,861	62,920,288	47,847,838
<u>Less:</u>			
Proceeds on disposal of moulds	<u>-</u>	<u>428,442<sup>2</sup></u>	<u>204,000<sup>2</sup></u>
Assessable profits	44,892,861	62,491,846	47,643,838
<u>Less:</u>			
Profits already assessed	<u>33,457,609</u>	<u>59,113,981</u>	<u>43,037,506</u>
Additional assessable profits	<u>11,435,252</u>	<u>3,377,865</u>	<u>4,606,332</u>
Additional tax payable thereon	<u>1,829,640</u>	<u>540,459</u>	<u>737,014</u>

Notes: <sup>1</sup> Moulds supplied to Company D  
<sup>2</sup> Sale proceeds of assets for which deduction under section 16G had been claimed but disallowed previously

- (8) The Taxpayer through its present Tax Representatives PricewaterhouseCoopers Limited did not accept the Assessor's proposal (although the royalty income issue was subsequently withdrawn).

## Evidence

4. The Taxpayer called two witnesses, Mr E and Mr F. These witnesses had previously filed witness statements. Mr Eugene Fung ('Mr Fung') on behalf of the Inland Revenue Department ('IRD') did not cross-examine either witness.

### *Mr E*

5. Mr E signed a witness statement dated 8 June 2011. He confirmed that the contents of his statement were correct. He told us that he was employed by the Taxpayer as a production controller. He explained that he was responsible for production scheduling.

6. He advised us that Company A (Country G) Limited (Company AG) solicited various retailers in Country G and then referred the orders from the retailers to the Taxpayer in respect of the mass production of Product Y.

7. He gave evidence as to how the designs prices, etc were agreed and how matters then progressed. He also told us that Company AG would register the design of Product Y by way of patents in Country G in order to protect the relevant interest of both the retailers and what he terms the 'Group of Company A' as a whole.

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

8. He told us about the unique nature of the design of the respective Product Y. He would communicate with Company AG to understand in detail the retailers' needs and requirements. He advised us that Company C was an independent mould manufacturer.

9. He would communicate with them in respect of the production of moulds and discuss the fee proposal for each mould which he in turn would look at and forward to Company AG.

10. Once the fee was agreed, Company C would prepare the drawings or design for producing the mould on behalf of the Taxpayer for the manufacturing of the specified Product Y.

11. He confirmed that Company C who manufactured the moulds for the Taxpayer were only allowed to use the moulds as instructed by them, that is solely to produce the Taxpayer's products having regard to their unique specifications. He told us that the moulds were provided by the Taxpayer as part of the contractual arrangements with their respective suppliers so as to ensure that they could produce Product Y to the exact specifications required. As the Product Y that were produced were specific to their customers' needs and bore Company A's trademark, these products would ultimately be used by retailers in Country G.

*Mr F*

12. Mr F was one of the two proprietors of Company C.

13. He was engaged in the business of mould design and production for the manufacturing of plastic products using mould injection techniques.

14. He told us that there was a factory in Country H ('Factory H'). He told us that Company C had been one of the major suppliers of Product Y for the Taxpayer since 1988. He would receive information as to the intended mould design from Company AG and the Taxpayer would send the drawings and the relevant design of Product Y to them. He would study the drawings and the relevant technical information and would revert to the Taxpayer with the design of the moulds based on the specifications given by Company AG to them through the Taxpayer.

15. Upon receipt of the approval from the Taxpayer, Company C would then manufacture the specified moulds in Factory H, and produce a few samples of Product Y for the Taxpayer's approval before launching into mass production.

16. For ease of logistics, the mould would not be physically transported to the Taxpayer but would be kept in Factory H for mass production to commence immediately upon receiving approval from the Taxpayer.

17. The moulds so produced were in fact used by Company C for the production of

Product Y solely for the Taxpayer.

18. He confirmed that all Product Y would bear Company A's trademark and therefore Company C was not able to produce any extra quantity and sell these to any other entities. He confirmed that Company C had never been given the ownership of the moulds, rather it had been allowed to use the moulds as instructed by the Taxpayer. He confirmed that the Taxpayer retained the title to the moulds.

19. Finally, he confirmed that most (if not all) of the moulds produced for the Taxpayer are now retained by them physically in Factory H.

20. Since there was no cross-examination, we have no hesitation in accepting the evidence both of Mr E and Mr F.

### **The issues**

21. As can be seen, the Taxpayer is seeking to deduct its expenditure in relation to the various moulds, incurred in the relevant years of assessment from 2000/01 to 2002/03.

22. Clearly, the expenditure on moulds is in the nature of capital expenditure and the deduction of which is expressly disallowed by section 17(1)(c) of the Inland Revenue Ordinance (Chapter 112) ('IRO'). Yet, there are exceptions to the general rule. Section 16G of the IRO permits deduction of capital expenditure if certain conditions are satisfied.

23. One of these conditions is that the capital expenditure must have been incurred on a 'prescribed fixed asset' within the specified meaning of the IRO.

24. We accept that this is the only issue which the Board has to resolve. This is clearly a question of construction and therefore purely a question of law.

25. Indeed, Mr Barlow, SC, in his written points of reply, agreed that there consensually was a common ground between the parties upon the facts, upon the legislative history of the relevant sections, upon the principles of statutory construction, and upon the legislative purpose behind the enactment of section 16G. Therefore, he confirmed that the only real point between the parties is the usage within section 16G(6) of the term 'lease' within the definition (for the purposes of section 16G only) of 'excluded fixed assets'.

### **The relevant statutory provisions**

26. Section 16 of the IRO provides as follows:

- '(1) In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the*



*production of profits in respect of which he is chargeable to tax under this Part for any period, including-*

*.....*

*(ga) the payments and expenditure specified in sections ..... 16G as provided therein; .....*

27. Section 16G of the IRO provides as follows:

*‘(1) Notwithstanding anything in section 17, in ascertaining the profits of a person from any trade, profession or business in respect of which the person is chargeable to tax under this Part for any year of assessment, there shall, subject to subsections (2) and (3), be deducted any specified capital expenditure incurred by the person during the basis period for that year of assessment.*

*(2) Where a prescribed fixed asset in respect of which any specified capital expenditure is incurred is used partly in the production of profits chargeable to tax under this Part and partly for any other purposes, the deduction allowable under this section shall be such part of the specified capital expenditure as is proportionate to the extent of the use of the asset in the production of the profits so chargeable to tax under this Part.*

*.....*

*(6) In this section—*

*“excluded fixed asset” means a fixed asset in which any person holds rights as a lessee under a lease;*

*“prescribed fixed asset” means—*

*(a) such of the machinery or plant specified in items ..... 26 ..... of the First Part of the Table annexed to rule 2 of the Inland Revenue Rules (Cap 112 sub. leg. A) as is used specifically and directly for any manufacturing process;*

*.....*

*but does not include an excluded fixed asset;*

*“specified capital expenditure”, in relation to a person, means any capital expenditure incurred by the person on the provision of a prescribed fixed asset .....*

28. Section 17 of the IRO provides as follows:

‘(1) *For the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of—*

.....

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

29. The definition of the ‘lease’ is expressly provided in section 2 of the IRO and states as follows:

‘“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, in the opinion of the Commissioner, the right under the agreement to purchase or obtain the property in the goods would reasonably be expected not to be exercised;*’

30. Item 26 of the First Part of the Table annexed to rule 2 of the Inland Revenue Rules (‘IRR’) refers to ‘Plastic manufacturing machinery and plant including moulds’.

### **The Taxpayer’s submissions**

31. Mr Barlow, SC draws our attention to section 16(1) that requires that, in the ascertaining of chargeable profits, ‘*there shall be deducted all outgoings and expenses to the extent they are incurred ..... by such person in the production of [chargeable] profits .....*’. Hence, he argues that sections 16(1) and 17(1)(c) expressly preclude the deduction of expenditure of a capital nature in the ascertaining of the assessable profits.

32. However, he then draws our attention to section 16G that exempts certain specified capital expenditure from that general prohibition. He drew our attention to Peterson v CIR [2005] STC 448 (PC) where Lord Millet stated at page 459 as follows:

‘[41] *Before considering the effect of these features, their Lordships must say something about the purpose for which depreciation allowances are granted by Parliament. They are not specific to film financing but are of*

*general application and have nothing to do with encouraging people to invest in films or indeed anything else. The statutory object in granting a depreciation allowance is to provide a tax equivalent to the normal accounting practice of writing off against profits the capital costs of acquiring an asset to be used for the purposes of a trade: see Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes) [2004] UKHL 51 at [39], [2005] STC 1 at [39], [2004] 3 WLR 1383 per Lord Nicholls of Birkenhead.'*

33. He asserts that section 16G contains a stand alone sub-regime of the IRO. He submits that section 16G overrides section 17 and section 16G has its own apportionment rule. He asserts that section 16G(6) defines '*specified capital expenditure*' as meaning (for the purpose of section 16G only) '*any capital expenditure incurred by the person on the provision of prescribed fixed asset .....*' unless the expenditure is deductible under another section of Part IV or the capital expenditure is incurred under a hire purchase agreement.

34. He asserts that section 16G(6) relevantly defines '*prescribed fixed asset*' as meaning (for the purposes of section 16G only) machinery or plant specified in the relevant Table annexed to rule 2 of the IRR as we have already stated above and that deals with plastic manufacturing machinery including moulds.

35. Section 16G(6) defines '*excluded fixed asset*' as meaning (for the purposes of section 16G only) '*a fixed asset in which any person holds rights as a lessee under a lease*'. He asserts there is no specific definition of '*lease*' within section 16G but he asserts that '*lease*' is a term of legal art and whether it is used in relation to land or as he asserts here in relation to a chattel, it means: a contractual entitlement to exclusive possession for a defined period of time.

36. However, section 2(1) of the IRO gives an exclusive definition of '*lease*' as set out above. Mr Barlow, SC argues that the extended inclusive definition creates a statutory fiction that an arrangement – whereunder a person other than the owner is permitted to use the machinery or plant – is a '*lease*' despite the fact that such arrangement is not a '*lease*' in law.

37. In short, he submits that the opening words of section 2(1) '*unless the context otherwise requires*' dictate that there must be a '*context*' for the primary or technical or ordinary usage of the term '*lease*' which he asserts is section 16G and elsewhere and a '*context*' for the extended or fictional usage of the term '*lease*' which he says is applicable to section 39E.

38. However, both parties agree that section 39E is not applicable to the appeal, although Mr Barlow, SC submits it is not irrelevant because it illustrates the engagement of the extended definition of '*lease*'.

39. In short, his argument is that this extended definition works within the specific anti-avoidance regime of section 39E in, as much as it provides, what he says, is '*efficacy*'

or indeed ‘potency’ to the IRD’s specific anti-avoidance powers.

40. Mr Barlow, SC’s submission is that on the evidence and having regard to the general legal sense, there was no ‘lease’ as one asserts in the general legal sense, that is meaning ‘*a contract by which the owner of an asset grants another person the right to the exclusive possession of the asset for a stated or ascertained period of time, usually in return for consideration*’. As such, he asserts there was no ‘lease’ in the present case.

41. The definition of ‘lease’ in section 2 of the IRO must have been enacted only in the context of section 39E of the IRO, that is to deal with and reduce tax avoidance or tax deferral by what is known as ‘*sale and leaseback*’ or any other tax avoidance devices. Therefore, Mr Barlow, SC submits that ‘lease’ should therefore be interpreted so it is consistent with the intent of the legislation.

### **General principles on statutory interpretation**

42. There was considerable emphasis by the parties in their written submissions and in referring to the cases which they put before us as to the general principles on statutory interpretation which applied. However, in the end, there was little difference between the position taken by Mr Barlow, SC and Mr Fung as to those relevant principles and the legislative purpose behind the enactment of section 16G.

43. If required to choose between the submissions of counsel, we have no hesitation in accepting the submission put forward to us by Mr Fung as to the applicable general principles on statutory interpretation. We can summarize these as follows:

- (a) In interpreting a statute, the court’s task is to ascertain the intention of the legislature as expressed in the language of the statute. This is an objective exercise. We accept that the court is not engaged in an exercise of ascertaining the legislative intent on its own (see HKSAR v Cheung Kwun Yin (2009) 12 HKCFAR 565 at paragraph 11 (Li CJ)).
- (b) We accept that the modern approach is to adopt a purposive interpretation. The statutory language is construed, having regard to its context and purpose. Words are given their natural and ordinary meaning unless the context or purpose points to a different meaning. Context and purpose are considered when interpreting the words used and not only when an ambiguity may be thought to arise.
- (c) We accept that it is also necessary to read all of the relevant provisions together and in the context of the whole statute as a purposive unity in its appropriate legal and social setting (see Medical Council of Hong Kong v Chow Siu Shek (2000) 3 HKCFAR 144 at 154B-C).
- (d) The purpose of a statutory provision may be evident from the provision itself. It may be ascertained from the Explanatory Memorandum to the

Bill, or from statements made by responsible officials of the Government in relation to a Bill in the Legislative Council (see Director of Lands v Yin Shuen Enterprises Ltd (2003) 6 HKCFAR 1 at paragraphs 21 and 22 (Lord Millett NPJ), PCCW-HKT Telephone Ltd v Telecommunications Authority (2005) 8 HKCFAR 337 at paragraph 20 (Bokhary PJ) and Cheung Kwun Yin (above at paragraph 14 (Li CJ)).

### **The Commissioner's position**

44. Mr Fung submits that the IRD contends that the capital expenditures incurred by the Taxpayer on the moulds during the relevant years of assessment were not deductible for the following reasons:

- (a) He asserts that the Taxpayer's expenditures on moulds were capital in nature and would therefore prima facie be disallowed under section 17(1)(c) of the IRO.
- (b) The Taxpayer could not rely on the section 16G exceptions to section 17(1)(c) because of the following:
  - (1) There was an agreement under which a right to use the moulds was granted by the Taxpayer to another person, namely the manufacturer in Country H. He relies on the undisputed evidence given by Mr E and Mr F.
  - (2) He asserts that the arrangement in (a) above fell clearly and unequivocally within the definition of a '*lease*' in section 2 of the IRO.
  - (3) He asserts that the moulds were therefore '*excluded fixed assets*' within the definition of section 16G(6), namely fixed assets in which any person held rights as a lessee under a lease.
  - (4) He asserts therefore that by virtue of being '*excluded fixed assets*', the moulds used by the manufacturer in Country H were not '*prescribed fixed assets*' within the definition of section 16G(6).
  - (5) He asserts that the moulds used by the manufacturer in Country H were not '*prescribed fixed assets*', the capital expenditures incurred by the Taxpayer on the provision of them were not '*specified capital expenditure*' within the definition of section 16G(6).
  - (6) Therefore, the capital expenditures incurred by the Taxpayer on the provision of the moulds used by the manufacturer in the Mainland fell outside section 16G of the IRO.

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

45. Mr Fung draws to the Board's attention very strict and precise provisions set out in the IRO which deal with the way in which deductions can be claimed.

46. In respect of capital expenditure, he asserts that these are severely limited due to the specific terms of section 16G and as such, the Taxpayer can only come within the provisions in very limited circumstances.

47. He concludes that it is unequivocal that there was a lease arrangement between the Taxpayer and the manufacturer in Country H and as such, this falls squarely within the definitional section provided by section 2.

48. In his submissions, Mr Fung submits that the purpose of section 16G is to allow a taxpayer to claim deductions of a new head of capital expenditures as he asserts under the specific statutorily-defined '*prescribed fixed asset*' which would otherwise be disallowed by section 17(1)(c).

**Discussion**

49. We accept that a capital expenditure is only deductible under section 16G if it is a '*specified capital expenditure*' within the meaning of section 16G(6), namely '*any capital expenditure incurred by the person on the provision of a prescribed fixed asset*'.

50. In our view, it is quite clear that a '*prescribed fixed asset*' is defined in section 16G(6) to exclude an '*excluded fixed asset*', that is '*a fixed asset in which any person holds rights as a lessee under a lease*'.

51. We have no difficulties in coming to the conclusion that a '*lease*' is defined in section 2(1) to include '*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*'.

52. Hence, we accept that if the Taxpayer as in this case granted a right under any arrangement to use the moulds to another person and that the Taxpayer incurred capital expenditures on the provision of the moulds, such capital expenditures will not be a '*specified capital expenditure*' within the meaning of section 16G and no deduction can be made.

53. We have no difficulties also in holding that '*lease*' should not be given its ordinary or technical meaning in section 16G. We reject Mr Barlow, SC's submissions that '*lease*' should be given its ordinary or legal meaning.

54. We take the view that there is no basis for us to ignore the statutory definition of a '*lease*' and instead apply an ordinary or technical meaning to the word set out in section 16G.

55. Again, '*lease*' as we have previously stated is statutorily defined in section 2(1)

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

of the IRO. The word 'lease' is defined by a definition in the interpretation clause in section 2(1) and to 'include', amongst other things, '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'.

56. The wording utilized in section 2(1) is unequivocal and clear and we accept that when the word 'include' is used in an interpretation clause of a statute to define a word or phrase, it is ordinarily used to enlarge or expand on the ordinary meaning of the word or phrase.

57. We rely on Dilworth v Commissioner of Stamps [1899] AC 99; Thomas v Marshall [1953] AC 543 and Penny's Bay Investment Co Ltd v Director of Lands (FACV 8/09, 26.3.2010). In Penny's Bay Investment Co Ltd v Director of Lands, Lord Hoffman stated at paragraph 38 as follows:

*'When Parliamentary draftsman says that a term shall "include" something, he means that in addition to the terms having its ordinary, conventional meaning, it shall be deemed also to cover other things which might not be regarded as coming within that meaning.'*

58. We also have had the opportunity to consider two previous decisions of the Board of Review which have construed the word 'lease' according to the statutory meaning rather than its ordinary or legal meaning. In particular we refer to D61/08, (2009-10) IRBRD, vol 24, 184 where the Board stated at paragraph 47 as follows:

*'For the purpose of the IRO, the term 'lease' is defined widely ..... In our view, the IRO provides a broader meaning to the term than either its ordinary meaning or its legal definition in land law. An arrangement, which is not necessarily in writing, suffices.'*

59. We also rely on D19/09, (2009-10) IRBRD, vol 24, 483 at paragraph 49.

60. In our analysis, it is quite clear that the Taxpayer's expenditures on the moulds were capital in nature and would not be allowed to be deducted under section 17(1)(c) of the IRO.

61. In our view, there was quite clearly an arrangement under which a right to use the moulds was granted by the Taxpayer to the manufacturer in Country H.

62. Hence, having regard to the unequivocal and incontrovertible evidence that was never challenged, there was clearly an arrangement between the Taxpayer and the manufacturer in Country H under which the Taxpayer allowed the manufacturer in Country H to use the moulds to produce the Taxpayer's products.

63. In our view, looking at this matter as a whole, we take the view that the arrangement set out in the agreed facts and in the evidence of Mr E and Mr F, quite clearly

falls unequivocally within the definition of a '*lease*' as provided in section 2 of the IRO.

64. Therefore, in our analysis, the moulds used by the Taxpayer's manufacturer in Country H were therefore '*excluded fixed assets*' within the definition in section 16G(6), namely fixed assets in which any person holds rights as a lessee under a lease. Hence, the capital expenditures incurred by the Taxpayer on the provision of the moulds used by the manufacturer in Country H fell outside section 16G of the IRO.

65. We have given very careful consideration to Mr Barlow, SC's submissions on the legislative context of section 16G, the purpose for which it was enacted and that it is unrelated to tax avoidance schemes and devices which are covered by section 39E. It may be the case that it will be very difficult under any circumstances for any taxpayer to take advantage of the extended definition which Mr Fung puts forward but in our view, this extended definition is the correct interpretation of section 16G. The tax statutes here in Hong Kong are simple and straightforward and perhaps prevent and limit the impact of the efficacy of section 16G.

66. We are of the view that the appeal must be dismissed.

67. Finally, we wish to take this opportunity of thanking the parties for their assistance in respect of this matter.