Case No. D36/10

Profits tax – transfer of properties to immediate holding company at an undervalue – onward resale by immediate holding company to unrelated parties at a profit – whether sole or dominant purpose to obtain a tax benefit – sections 2, 14(1), 61A, and 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Miu Liong Nelson and Wan Ho Yan.

Date of hearing: 30 October 2009.
Date of decision: 31 December 2010.

The appellant, a company in members' voluntary winding up, disposed of its 3 shops at their book value of $7,950,000 to its immediate holding company on 30 May 2005.

By two provisional agreements dated 2 June 2005 and 15 June 2005, the immediate holding company then disposed of the 3 shops to unrelated parties at a total price of $10,400,000.

The Commissioner contends that section 61A is applicable to the appellant's disposal of its 3 shops to its immediate holding company and seeks to challenge the reduction in the amount of profits tax payable by the appellant.

Held:

1. The transfer of the 3 shops from the appellant to its immediate holding company for $7,950,000 was at an undervalue and not an arms-length transaction.

2. At the time of the internal transfer on 30 May 2005, both the appellant and the immediate holding company knew that the sales of the 3 shops to unrelated parties were imminent.

3. The market value of the 3 shops as at 30 May 2005 was $10,400,000 as there is no evidence of any material increase in market value of the 3 shops between 30 May 2005 and 2 June 2005 or 15 June 2005.

4. There was no commercial purpose for incurring extra costs and expenses for the internal transfer.

5. The tax benefit is the reduction in the amount of profits tax payable by the appellant resulting from the sale of its 3 shops at their book value of $7,950,000 instead of their market value of $10,400,000 to its immediate holding company.

6. Having regard to 'the 7 matters' of section 61A, save and except that there is no participation of any off-shore company, the Board arrives at an overall conclusion that the appellant and its immediate holding company entered into or carried out the transaction for the dominant purpose of enabling the appellant to obtain a tax benefit.

7. Exercising the power under section 61A(2), it would be in order for the Commissioner to assess the appellant on the basis that the internal sale was at its market value of $10,400,000 to counteract the tax benefit which would otherwise be obtained.

Appeal dismissed.

Cases referred to:

Ngai Lik Electronics Co Ltd v Commissioner of Inland Revenue (2009) 12 HKCFAR 296
Yick Fung Estates Limited v CIR [2000] 1 HKLRD 381
Commissioner of Inland Revenue v Tai Hing Cotton Mill (Development) Limited (2007) 10 HKCFAR 704
D109/03, IRBRD, vol 19, 14
Commissioner of Inland Revenue v HIT Finance Limited (2007) 10 HKCFAR 717
Shui On Credit Co Ltd v Commissioner of Inland Revenue (2009) 12 HKCFAR 392

Taxpayer represented by a representative of the Appellant's ultimate holding company.
Tam Tai Pang and Leung To Shan for the Commissioner of Inland Revenue.

Decision:

Introduction

1. The appellant is a company in members' voluntary winding up.

2. By an assignment dated 30 May 2005, the appellant assigned 3 shops it owned to its immediate holding company for $7,950,000.

3. By a provisional agreement dated 2 June 2005, its immediate holding company agreed to sell one of those 3 shops ('the 2 June 2005 shop') to an independent third party for $4,000,000.

4. By another provisional agreement dated 15 June 2005, its immediate holding company agreed to sell the other 2 shops ('the 15 June 2005 shops') to another independent third party for $6,400,000.

5. By a supplemental assignment dated 21 June 2005, the appellant assigned the lavatory which was omitted to be assigned in the assignment dated 30 May 2005 referred to in paragraph 2 above.

6. The appellant had a tax loss of $121,850 brought forward from the 2004/05 year of assessment. Not taking the dealings with the 3 shops into consideration, it had assessable profits of $84,821 for the 2005/06 year of assessment.

7. The appellant's immediate holding company:

(1) had a tax loss of $35,762,018 brought forward from the 2004/05 year of assessment; and

(2) reported profits of $4,576,857 in the 2005/06 year of assessment, before set off against loss brought forward from the 2004/05 year of assessment.

8. The assessor assessed the appellant to profits tax for the 2005/06 year of assessment by adjusting the selling price of the 3 shops to $10,400,000, that is, $4,000,000 + $6,400,000. The appellant objected to such assessment. The Deputy Commissioner of Inland Revenue considered that section 61A of the Inland Revenue Ordinance, Chapter 112, was applicable and confirmed the assessment.

No response by solicitor liquidator to invitation to agree facts not in issue

9. By letter dated 17 September 2009, the assessor wrote to the appellant's liquidator, a practicing solicitor ('the solicitor liquidator') asking if the appellant would agree with the facts under section 1 of the Determination and, if not, indicating the matters in disagreement.

10. There was no response from the solicitor liquidator.

11. The solicitor liquidator's silence is difficult to understand because he has previously commented on the statement of facts in draft form.

12. His lack of response is hardly helpful to:

(1) the appellant because the absence of any agreed fact means that the appellant which bears the burden of proof has to prove every fact

material to its success, including those which should be common ground; or

(2) the Board in assisting the Board to note the matters not in issue and then focus on matters in issue.

The factual background

13. Based on the materials placed before and accepted by us, we find the following facts.

14. The appellant's audited financial statements for the year ended 31 December 2004 stated that:

(1) the 3 shops it owned were classified as 'properties held for sale';

(2) the 3 shops had a value of $8,050,000 as at 31 December 2003; and

(3) the 3 shops had a value of $7,950,000 as at 31 December 2004, having had their value written down by $100,000 as 'write-down of properties held for sale to estimated net realisable value'.

15. By an assignment dated 30 May 2005, the appellant assigned the 3 shops to its immediate holding company for $7,950,000.

16. By a provisional agreement dated 2 June 2005, its immediate holding company agreed to sell the 2 June 2005 shop to an independent third party for $4,000,000. The sale was subject to existing tenancy. The tenancy's term was from 16 October 2003 to 15 October 2005 at a monthly rental of $18,000.

17. By another provisional agreement dated 15 June 2005, its immediate holding company agreed to sell the 15 June 2005 shops to another independent third party for $6,400,000. These 2 shops were subject to existing tenancy. The tenancy's term was from 17 May 2005 to 16 May 2008 at a monthly rental of $36,000. The previous tenancy was from 17 May 2002 to 16 May 2005 at a monthly rental of $29,000.

18. By a supplemental assignment dated 21 June 2005, the appellant assigned the lavatory which was omitted to be assigned in the assignment dated 30 May 2005 referred to in paragraph 15 above.

19. At an extraordinary general meeting held on 23 December 2005, the appellant resolved to be wound up voluntarily and the solicitor liquidator was appointed as the liquidator of the appellant.

20. The appellant had a tax loss of $121,850 brought forward from the 2004/05 year of assessment. Not taking the dealings with the 3 shops into consideration, it had assessable profits of $84,821 for the 2005/06 year of assessment.

21. The appellant's immediate holding company:

(1) had a tax loss of $35,762,018 brought forward from the 2004/05 year of assessment; and

(2) reported profits of $4,576,857 in the 2005/06 year of assessment, before set off against loss brought forward from the 2004/05 year of assessment.

The hearing

22. The notice of appeal was given by the solicitor liquidator. However, by letter dated 13 October 2009, the solicitor liquidator informed the Clerk to the Board of Review that a named person from the appellant's ultimate holding company would present the case for the appellant and that a named staff from his office would:

' attend the hearing on my behalf for watching-brief'.

23. The person from the appellant's ultimate holding company ('the CPA') was a non-practising certified public accountant in the employ of the appellant's ultimate holding company. The CPA felt able to make all sorts of factual allegations in his witness statement, despite the fact that he was not in a position to testify on any material or relevant fact because:

(1) He had never been employed by the appellant and had never been employed by the appellant's immediate holding company.

(2) He was not a decision maker, whether of the appellant, its immediate holding company or its ultimate holding company. He was merely a group employee working in the back office in Hong Kong.

(3) All decisions were made overseas by directors of the ultimate holding company group. CPA was not privy to any of the decisions, not even the decision making process.

24. When pressed under cross-examination and when confronted with conflicting assertions, he was vague and evasive.

25. We attach no weight to his evidence because he was not in a position to testify on any material or relevant fact and because he did not impress us as a reliable or credible witness.

26. The CPA was the only witness called by the appellant.

27. The respondent was represented by Mr Tam Tai Pang, acting chief assessor, who did not call any witness.

28. The CPA did not cite and did not make any submission on:

(1) any of the Court of Final Appeal judgments on section 61A; or

(2) any other authorities.

29. In short, we received no assistance from the solicitor liquidator or the CPA on facts and no assistance from the CPA on how the law should be applied to the facts in this case.

Ngai Lik directions

30. In Ngai Lik Electronics Co Ltd v Commissioner of Inland Revenue (2009) 12 HKCFAR 296 at paragraphs 137 and 138, the Court of Final Appeal required the Board to give directions in section 61A cases:

> '*137. In my view, this case demonstrates a clear need in section 61A proceedings before the Board for the Revenue to identify with workable clarity at an early stage the tax benefit which it seeks to challenge, the transaction which it says had the effect of conferring that tax benefit on the taxpayer and the person or persons having the relevant dominant purpose. Such particulars should be provided as a matter of procedural fairness and to facilitate a sound analysis of the case.*
>
> *138 The practice of the Board in section 61A cases should be to issue directions for such particulars to be supplied by the Revenue – which may be particulars in support of alternative cases – before the start of the hearing. That is not to say that the Revenue's particulars cannot be altered. Amendment should be permitted if the evidence or submissions support the existence of a viable alternative or different scheme or tax benefit unless this causes unfairness which cannot be alleviated by case management measures (such as adjournments, the recalling of witnesses, the calling of new witnesses, etc). The aim should be that everyone knows at every stage how section 61A is sought to be applied in the particular case.'*

31. By the Clerk's letter dated 4 September 2009, the Chairman of the Board directed the respondent as follows:

> '... if the Commissioner contends that section 61A of the Inland Revenue Ordinance, Cap. 112, is applicable, the Commissioner shall provide to the appellant by **30 September 2009** particulars of the tax benefit which the

Commissioner seeks to challenge, the transaction which the Commissioner says has the effect of conferring the tax benefit on the appellant and the person or persons having the relevant dominant purpose.'

32. By letter dated 30 September 2009, the assessor wrote to the solicitor liquidator confirming that:

'the Commissioner contends that section 61A of the Inland Revenue Ordinance applies to this case. The tax benefit which the Commissioner seeks to challenge is the reduction in the amount of profits tax payable by [the appellant] resulting from the sale of its [3 shops] at their book value as at 31 December 2004 (i.e. $7,950,000) instead of their market value at the time of sale (which the Commissioner argues was no less than $10,400,000). The transaction which has the effect of conferring the tax benefit is the sale of the [3 shops by the appellant to its immediate holding company] at a price below market value and the resale of [the 3 shops by the appellant's immediate holding company] to unrelated parties. The persons having the dominant purpose of enabling [the appellant] to obtain the tax benefit are [the appellant and its immediate holding company].'

33. By letter dated 20 October 2009, the assessor wrote to the solicitor liquidator stating that:

'... the Revenue will in the hearing put forward an alternative case in relation to the transaction being impugned. The transaction under the alternative case is the sale of [the 3 shops by the appellant to its immediate holding company] at a price below market value. The tax benefit challenged and the persons having the dominant purpose of enabling [the appellant] to obtain the tax benefit are the same as those stated in my letter dated 30 September 2009.'

Relevant statutory provisions

34. Section 2 provides, among others, that:

'*"profits arising in or derived from Hong Kong" (於香港產生或得自香港的利潤) for the purposes of Part IV shall, without in any way limiting the meaning of the term, include all profits from business transacted in Hong Kong, whether directly or through an agent'.*

35. Section 14(1) provides that:

'*Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession*

or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.'

36. Section 61A provides that:

'*(1) This section shall apply where any transaction has been entered into or effected after the commencement of the Inland Revenue (Amendment) Ordinance 1986 (7 of 1986) (other than a transaction in pursuance of a legally enforceable obligation incurred prior to such commencement) and that transaction has, or would have had but for this section, the effect of conferring a tax benefit on a person (in this section referred to as 'the relevant person'), and, having regard to –*

(a) the manner in which the transaction was entered into or carried out;

(b) the form and substance of the transaction;

(c) the result in relation to the operation of this Ordinance that, but for this section, would have been achieved by the transaction;

(d) any change in the financial position of the relevant person that has resulted, will result, or may reasonably be expected to result, from the transaction;

(e) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant person, being a change that has resulted or may reasonably be expected to result from the transaction;

(f) whether the transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm's length under a transaction of the kind in question; and

(g) the participation in the transaction of a corporation resident or carrying on business outside Hong Kong,

it would be concluded that the person, or one of the persons, who entered into or carried out the transaction, did so for the sole or dominant purpose of enabling the relevant person, either alone or in conjunction with other persons, to obtain a tax benefit.

(2) Where subsection (1) applies, the powers conferred upon an assessor under Part X shall be exercised by an assistant commissioner, and such assistant commissioner shall, without derogation from the powers which

he may exercise under that Part, assess the liability to tax of the relevant person –

(a) as if the transaction or any part thereof had not been entered into or carried out; or

(b) in such other manner as the assistant commissioner considers appropriate to counteract the tax benefit which would otherwise be obtained.

(3) In this section –

"tax benefit" (稅項利益) means the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof;

"transaction" (交易) includes a transaction, operation or scheme whether or not such transaction, operation or scheme is enforceable, or intended to be enforceable, by legal proceedings.'

37. Section 68(4) provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the appellant.

Relevant Hong Kong court cases

Yick Fung

38. In Yick Fung Estates Limited v CIR [2000] 1 HKLRD 381 at page 399, Rogers JA said the approach was an objective one:

'*... the tests set out in s.61A have to be applied objectively.*
There are seven matters (a) to (g) to which the section requires that regard must be had. On a clear construction of the subsection, the section would not be relevant or the subject matter of consideration unless there was a tax benefit, in other words, the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof. In this case, it is said that there has been an avoidance of tax in respect of HK$108,327,586 profits or at any rate, there has been a reduction in the amount of tax that would otherwise have been payable. On that basis, the various matters at (a) to (g) have to be considered and if upon that exercise, the conclusion would be arrived at that the person who entered into or carried out the transaction did so for the sole or dominant purpose of obtaining a tax benefit, the Assistant Commissioner may exercise one of the two powers set out in sub-s.(2).

In this Court, there was some discussion as to whether it is necessary for more than one item in matters (a) to (g) to indicate the sole or dominant purpose for it to be possible that that conclusion be arrived at. In my view, the posing of the

question itself possibly indicates an erroneous approach to the section. Clearly, what must happen is that those matters must be considered and the strength or otherwise of the various resulting conclusions from considering those matters must be looked at globally. On the basis of that assessment, it must be decided whether the sole or dominant purpose was the obtaining of a tax benefit. It may be observed, for example, that one or other of the matters in (a) to (g) may be strongly or weakly suggestive of a purpose of obtaining a tax benefit or may be strongly or weakly suggestive of some other purpose. The Assistant Commissioner who undertakes such task has to use his own common sense and apply the results of his deliberations in respect of each matter and come to an overall conclusion.' (at p. 399).

'The Board approached the matter on the basis that the word "form" related to the legal effect or, as I would put it, the legal nature of the transaction and that the substance related to the practical or commercial end result of the transaction. In that respect, I would have no cause to disagree with the way in which this was put.' (at p. 400)

Tai Hing

39. On 4 December 2007, the Court of Final Appeal handed down 2 judgments which explained why section 61A is a much more powerful and flexible weapon in the hands of the Commissioner.

40. Commissioner of Inland Revenue v Tai Hing Cotton Mill (Development) Limited (2007) 10 HKCFAR 704 is one of them. It was the Commissioner's appeal from D109/03, IRBRD, vol 19, 14. The Board held that the transaction did not have, and would not have had but for section 61A, the effect of conferring a tax benefit on the taxpayer and that even if the Commissioner was right on the tax benefit point, the tax benefit was not the sole or predominant purpose of the transaction – a sale in return for a share of profits was a common form of transaction with a commercial justification[1]. The Board's decision was reversed by the judge, restored by the Court of Appeal and reversed by the Court of Final Appeal.

41. On the question of tax benefit, Lord Hoffmann NPJ[2] held that:

(a) '*A benefit is something which makes your position better. The word invites a comparison ... The Ordinance speaks of a transaction which has the 'effect' of conferring a tax benefit. A transaction may have an effect on tax liabilities which arise at a future date. In this case, the price fixed for the sale of the land had an effect on the taxpayer's liability for tax on the profits of the development.*[3]'.

[1] As summarised by Lord Hoffmann NPJ at paragraph 11.
[2] The other judges agreed with Lord Hoffmann's judgment.
[3] At paragraph 13.

(b) *'... s.61A raises a straightforward question of causation and comparison. If the effect of the transaction is that your liability to tax is less than it would have been on some other appropriate hypothesis, you have had a tax benefit. Provided that the calculation is properly done, the section is not concerned with how the elements of the calculation are categorised for other purposes of tax law*[4]*'.*

(c) *'The real question is the alternative hypothesis which the comparison requires. That is a question of construction. It must be gathered from the terms of the section as a whole. Section 61A is what is called in the trade a general anti-avoidance rule. It applies generally to any method of avoiding any tax*[5]*.'*

(d) *'... s.61A(2) gives the Commissioner an option. Paragraph (a) says that she may assess the taxpayer as if the transaction had not been entered into or carried out. That is the equivalent of the New Zealand provision considered by Lord Diplock in Europa Oil*[6]*. But she may also, under paragraph (b), assess the taxpayer in such other manner as she considers appropriate 'to counteract the tax benefit which would otherwise be obtained'. The hypothesis of an assessment under (b) must therefore be, not only that the actual transaction did not take place, but that some other transaction took place instead. Otherwise (b) would add nothing to (a). What that other transaction might be is a question to which I shall return later, but the effect of s.61A is that, unlike the position under the New Zealand Act, the tax benefit does not have to relate some other pre-existing source of income, external to the transaction. The Commissioner, under s.61A(2)(b), can assess the taxpayer on the hypothesis that there was a transaction which created income, but without the features which conferred the tax benefit. That makes s.61A a much more powerful and flexible weapon in the hands of the Commissioner than the New Zealand section.'*[7]

(e) The Commissioner *'may adopt the hypothesis which the evidence*[8] *suggests was most likely to have been the transaction if the taxpayer had not been able to secure the tax benefit'*[9]*.*

(f) *'The transaction had, in general terms, a proper commercial purpose. But, as the High Court said in Spotless Services* case[10] *(at p.416) —*

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[4] At paragraph 14.
[5] At paragraph 15.
[6] Europa Oil (NZ) Ltd v Inland Revenue Commissioner [1976] 1 WLR 464
[7] At paragraph 17.
[8] Subject to and see paragraph 52 below.
[9] At paragraph 21.
[10] Commissioner of Taxation v Spotless Services Ltd (1996) 186 CLR 404.

> *"The "shape" of that transaction need not necessarily take only one form. … A particular course of action may be … both "tax driven" and bear the character of a rational commercial decision. The presence of the latter characteristic does not determine the answer to the question whether … a person entered into or carried out a "scheme" for the "dominant purpose" of enabling the taxpayer to obtain a "tax benefit"."'*[11]

42. On the question of purpose, Lord Hoffmann NPJ said that the appropriate question is the purpose of the parties in adopting the specific terms which had the effect of conferring a tax benefit; the test is an objective one; a particular course of action may be both 'tax driven' and bear the character of a rational commercial decision. The notion that each group company was trying to get the best deal it could is quite unreal. The land was simply being passed from one pocket to the other. It did not matter to the parties what the terms of sale were. In economic terms, the result would have been exactly the same whatever the taxpayer agreed to pay.

(a) *'The level of generality at which the section requires one to characterise the transaction must depend upon what, for the purposes of the section, counts as a tax benefit. If a tax benefit involves simply a comparison between the tax liability in consequence of the transaction and what it would have been if there had been no transaction, then it is appropriate to ask the question about purpose by reference to the transaction in the most general terms. On the other hand, if it involves (as in the case of s.61A) a comparison with what the liability would have been if there had been a different transaction, then the appropriate question is the purpose of the parties in adopting the specific terms which had the effect of conferring a tax benefit. In this case, that means the formula for fixing the price.'*[12]

(b) *'The Board accepted the evidence of an estate agent that such arrangements were "commonly found in Hong Kong in cases where land is sold with a view to being redeveloped." There was nothing 'odd, unusual or uncommercial' in the terms.'*[13]

'That evidence certainly establishes that an agreement to share profits is not inconsistent with the parties having been dealing at arms' length. Such terms do not suggest that the agreement was collusive or that the parties had any purpose other than each to get the best deal it could. But these parties were plainly not dealing at arms' length. They were parent and subsidiary; in economic terms the same enterprise under the same direction. The notion that each was trying to get the best deal it could is quite unreal. The land was simply being passed from one pocket to the

[11] At paragraph 23.
[12] At paragraph 24.
[13] At paragraph 25.

other. It did not matter to the parties what the terms of sale were. In economic terms, the result would have been exactly the same whatever the taxpayer agreed to pay. It is therefore necessary to ask why the parties chose the price formula which they did rather than fixing it in some other way.'[14]

'What purpose could the parties possibly have had in choosing this method of calculating the price rather than some other method? The answer must in my opinion be that the purpose of the transaction was to mop up as large a portion of the taxpayer's profits as seemed decent in the circumstances and transfer them tax free to Tai Hing.'[15]

(c) *'The question in s.61A is not what the purpose of the parties actually was, but the objective question of what would be concluded from a consideration of the various matters listed in paragraphs (a) to (g).'*[16]

(d) *'There remains the question of the alternative hypothesis upon which the Commissioner was entitled to assess the taxpayer. If the parties had not adopted the formula which they did, I think that the most likely method of fixing the price would have been to take market value. That would have caused the least distortion to the balance sheets and profit and loss accounts of the two companies and produced the most realistic result. It follows that the Commissioner was entitled, as she did, to employ this hypothesis under s.61A(2)(b).'*[17]

HIT Finance

43. Commissioner of Inland Revenue v HIT Finance Limited (2007) 10 HKCFAR 717 is the other case. Lord Hoffmann NPJ[18] elaborated on the meaning of 'tax benefit' and counteracting the tax benefit:

(a) *'A tax benefit simply means a difference favourable to the taxpayer between his tax liability computed on one basis and his liability computed on a different basis. It does not mean any particular element in that computation.'*[19]

(b) *'In my opinion a transaction with terms or features which reduce the taxpayer's liability, compared with what it would have been without them, confers a tax benefit upon him. If those terms or features were included for the sole or predominant purpose of securing that benefit, the*

[14] At paragraph 26.
[15] At paragraph 27.
[16] At paragraph 28.
[17] At paragraph 29. However, this is subject to paragraph 52 of this Decision.
[18] The other judges agreed with Lord Hoffmann's judgment.
[19] At paragraph 17.

Commissioner may counteract that benefit under s.61A(2)(b) by assessing him on the basis that the transaction took the form it might reasonably be expected to have taken without those terms or features.'[20]

Ngai Lik

44. In Ngai Lik, Ribeiro PJ[21] set out the three intersecting conditions which must be satisfied for section 61A to apply:

> '*34. Three intersecting conditions must be satisfied before the Commissioner can exercise her power to raise an assessment under section 61A(2). They are that:*
>
> *(a) a transaction (broadly defined to include an operation or scheme) has been entered into;*
>
> *(b) such transaction has, or would have had but for this section, the effect of conferring a tax benefit on the relevant person (that is, on the taxpayer against whom the section has been invoked); and*
>
> *(c) viewing the transaction through the prism of the seven matters enumerated in section 61A(1)(a) to (g), it would objectively be concluded that it was entered into or carried out for the sole or dominant purpose of enabling the taxpayer to obtain a tax benefit.*
>
> *35. If section 61A is to be applied, it is essential to identify with some precision what the tax benefit allegedly conferred (or which would, but for the section be conferred) on the taxpayer consists of. Only then can one confidently identify the transaction, if any, which has the effect of conferring that tax benefit on him. And only then is one able to examine that transaction in the light of the seven specified matters to determine whether its sole or dominant purpose is to enable the taxpayer to obtain a tax benefit.*
>
> *36. It will be necessary later to consider the meaning of "tax benefit" as defined in section 61A(3). However, for present purposes, the point to be emphasised is that the three interlocking conditions – transaction, tax benefit and dominant purpose – must be properly aligned and approached with the necessary degree of precision if the application of section 61A is not to miscarry.*
>
> *37. Moreover, as discussed more fully later, where an assessment is raised under section 61A, it must be justifiable as a reasonable and proper exercise of the power.'*

[20] At paragraph 18. But this is subject to paragraph 52 of this Decision.
[21] The other judges agreed with Ribeiro PJ's judgment.

45. His Lordship went on to hold that the Commissioner is permitted as a matter of law to proceed on the basis of a pared-down scheme provided:

> '*79. ... (i) that the stripped down scheme and tax benefit are consistent with the Board's findings and correspond to the statutory definitions of those concepts; and (ii) that permitting the Commissioner to proceed on such a notionally amended basis causes no procedural or other unfairness to the taxpayer.'.*
>
> '*81. A degree of support for this approach to section 61A may be derived from section 61A(2)(a) which permits the Commissioner to fashion her assessment as a response to "any part of" a transaction caught by the provision, which suggests that she can ignore irrelevant parts.'*
>
> '*82. ... If there is a viable basis for establishing a scheme which has the effect of conferring a tax benefit within the meaning of the Ordinance, the Commissioner should be permitted to proceed on that basis notwithstanding what may have been earlier misconceptions on her part – provided always that procedural fairness to the taxpayer can be assured.'*

46. On dominant purpose, Ribeiro PJ said at paragraph 98 the question was an objective one.

47. He gave preliminary comments on the 7 matters,:

> '*(a) It appears to me that there is a qualitative difference between the first three items and the four remaining matters. The matters in paragraphs (a), (b) and (c) give guidance on methodology – guidance as to how the facts are to be approached in addressing the question of dominant purpose; while paragraphs (d) to (g) point to certain classes of fact as possible signposts to the requisite dominant purpose.*
>
> *(b) Thus, paragraph (a) tells us that it is permissible to look at the genesis of the transaction and also at the actual manner of its implementation. We are not confined simply to the features of the scheme itself or simply to its terms as set out on paper.*
>
> *(c) Paragraph (b) indicates that one is entitled to look beyond the form and at the substance of the transaction, making it plain, for instance, that approaches such as that of Lord Tomlin in IRC v Duke of Westminster,[22] confining the court to the legal forms has no place in the section 61A regime. This was a point made by the High Court of Australia in the*

[22] [1936] AC 1 at 19.

context of similar Australian legislation in Commissioner of Taxation of the Commonwealth of Australia v Spotless Services Limited.[23] *Clearly, paragraph (b) overlaps with the other paragraphs as one is in each case looking at the substance and not just the form of the relevant arrangement.*

(d) Paragraph (c) requires the fiscal effects of the overall transaction to be assessed, a matter closely overlapping with the anterior requirement of being satisfied that the scheme had the effect of conferring a tax benefit on the taxpayer.

(e) Paragraphs (d) and (e) require us to look at the financial effects of the particular scheme on the taxpayer and also on persons connected with the taxpayer, such as the group to which a taxpayer company belongs. It may be highly significant under paragraph (d) that the scheme brings about no changes to the taxpayer's financial position while at the same time producing a tax benefit. Or, under paragraph (e), it may be significant that the scheme involves transactions among group members resulting in an unchanged financial position for the group as a whole but in the conferment of a tax benefit on the taxpayer. As Lord Nolan pointed out in IRC v Willoughby:

> *"The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option."*

(f) Similarly, the fact that the scheme incorporates dealings which are not at arm's length may (as paragraph (f) indicates) be an important signpost since commercial dealings are normally conducted at arm's length and the uncommercial features of a transaction may suggest that it was entered into with the dominant purpose of producing a tax benefit for the taxpayer.

(g) The participation of an offshore corporation in the transaction (mentioned in paragraph (g)) might be a pointer to the requisite dominant purpose because it may indicate an attempt to exploit for tax avoidance purposes, the source requirement in the charging provisions of section 14.'

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[23] (1996) 186 CLR 404 at 414, per Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ.

48. His Lordship went on to explain that the matters should be approached qualitatively with a feel for the particular circumstances of each case and not by mechanically ticking off boxes in every single case; that the predominant purpose of the parties in passing group profits from one pocket to another by entering into the price fixing arrangement was to obtain a tax benefit for the taxpayer; and that the Commissioner's power must therefore be exercised on the basis of a reasonably postulated hypothetical transaction which produces an assessment designed rationally to counteract the tax benefit:

> '*100. The foregoing comments on the seven matters listed in section 61A are obviously not in any way intended to be comprehensive or exhaustive. I seek merely to emphasise the need to approach those matters qualitatively with a feel for the particular circumstances of each case. While it is necessary to have regard to each of the seven matters, this does not mean that they should be approached as boxes to be mechanically ticked off in every single case, an approach which has sometimes led to inapt attempts to force the facts into one pigeon-hole or other.'*

> '*110. When one asks why the parties entered into the price-fixing arrangement which resulted in group profits being passed from one pocket to another, the irresistible conclusion is that this was done with the dominant purpose of obtaining a tax benefit for the taxpayer.'*

> '*113. Option (a) is relatively straightforward: the taxpayer is assessed as if the transaction had not been entered into or carried out. But if option (b) is chosen, the assessment must be designed "to counteract the tax benefit which would otherwise be obtained". The power must therefore be exercised on the basis of a reasonably postulated hypothetical transaction which produces an assessment designed rationally to counteract the tax benefit. The assessment cannot be raised in some arbitrary amount or arrived at upon some basis that is unreasonable or not rationally related to the tax benefit in question. Such an assessment would not be a proper exercise of the power conferred by section 61A(2).'*

49. His Lordship concluded by explaining at paragraph 121 that where as in that case, the exercise of the Commissioner's power was shown to have miscarried, the onus under section 68(4) is discharged and at paragraph 134 that where section 61A(1) was engaged, section 61A(2) applies in mandatory terms.

Shui On Credit

50. In Shui On Credit Co Ltd v Commissioner of Inland Revenue (2009) 12 HKCFAR 392, Lord Walker NPJ held that section 61A did not arise for decision and it would be inappropriate for the Court of Final Appeal, as a court of last resort, to embark on

any elaborate discussion of how section 61A might have applied in a hypothetical situation[24].

51. At paragraph 6, his Lordship decided the question left open in Ngai Lik, that is, whether section 61A applies if the supposed tax benefit would not have been achieved even in the absence of section 61A:

> '*Section 61A was enacted in 1986 as a general anti-avoidance measure. It can be applied so as to assess a person to tax only if (among other conditions) a transaction has been effected (s.61A(1)):*
>
> > *"and that transaction has, or would have had but for this section, the effect of conferring a tax benefit on a person (in this section referred to as "the relevant person").*"
>
> *If the supposed tax benefit would not have been achieved even in the absence of s.61A (in colloquial terms, if for more mundane reasons the tax-avoidance scheme simply did not work) then logically s.61A cannot apply, as there is no tax benefit in the statutory sense. In a recent decision, Ngai Lik Electronics Co. Ltd v. CIR, 24 July 2009, FACV No. 29 of 2008, paras 93-97, this Court expressly left open the question whether that proposition is correct. The argument in the present case proceeded, in my view correctly, on the basis that it is correct. The question previously left open should now be taken to have been answered : a tax benefit in the statutory sense is required before s.61A is engaged, and so that section can apply only to a transaction which would otherwise avoid tax.'*

52. At paragraph 54, his Lordship commented on what Lord Hoffmann NPJ said in paragraphs 21 and 29 in Tai Hing:

> '*In Tai Hing (paras 21 and 29) Lord Hoffmann NPJ made some general observations about the appropriate hypothesis which counsel for the taxpayer seized on as indicating that the appropriate hypothesis was a matter for evidence, and even a matter that should have been put to the taxpayer's witnesses. I do not think that it is the right approach, and I do not think that Lord Hoffmann NPJ intended his observations to be taken in that way. The scope of the Commissioner's powers under s.61A(2) is a question of statutory construction (Tai Hing at para.15). The exercise of those powers is for the Commissioner's judgment, subject to public law constraints. Of course the Commissioner must have regard to the facts as agreed or found by the Board. But any inquiry into the subjective attitudes of the taxpayer and its associates would be inconsistent with the objective approach that is one of the essential features of s.61A. In some cases the taxpayer or associates of the taxpayer may have been cross-examined before the Board as to why they preferred the*

[24] At paragraph 44. The other judges agreed with his judgment.

> *impugned transaction to simpler and more natural alternatives. But that evidence would be directed to the issue of "sole or dominant purpose" and would not be of much relevance (and certainly not conclusive) as to the appropriate course to be taken under s.61A(2)(b). The Australian case of Commissioner of Taxation v. Hart (2004) 217 CLR 216 (in the passage at p.224 on which the taxpayer's counsel relied) seems to be an example of that sort of thing.'*

The transaction

53. The transaction as identified by the respondent in the assessor's letter dated 30 September 2009[25] is:

> The sale of the 3 shops by the appellant to its immediate holding company at a price below market value and the resale of the 3 shops by the appellant's immediate holding company to unrelated parties.

54. The alternative transaction as identified by the respondent in the assessor's letter dated 20 October 2009[26] is:

> The sale of the 3 shops by the appellant to its immediate holding company at a price below market value.

The CPA did not object to the respondent's reliance on her alternative case. We permit the respondent to rely on her alternative case and for reasons given at paragraph 85 below, do not consider it necessary to deal with the respondent's alternative case.

The tax benefit

55. The tax benefit as identified by the assessor is:

> The reduction in the amount of profits tax payable by the appellant resulting from the sale of its 3 shops at their book value as at 31 December 2004 (that is, $7,950,000) instead of their market value at the time of sale (which the Commissioner argues was no less than $10,400,000).

The persons with the dominant purpose

56. On the respondent's case, the persons having the dominant purpose of enabling the appellant to obtain the tax benefit are the appellant and its immediate holding company.

Further findings of fact

[25] See paragraph 32 above.
[26] See paragraph 33 above.

57. The CPA asserted the following in paragraph 5 of his witness statement:

> ' 5. ... in order to reduce unnecessary running costs and redundant operations, [the ultimate holding company] decided to restructure the group by winding up [the appellant] and transferring the [3 shops] being [the appellant's] all remaining assets to [its immediate holding company].'

58. Such assertion is belied by the objective facts:

(1) The CPA acknowledged in paragraph 11 of his witness statement that the estate agent approached the appellant in about April 2005 about the sale of the 3 shops.

(2) The assignment of the 3 shops by the appellant to its holding company was dated 30 May 2005. The provisional agreements made by the appellant's immediate holding company to unrelated parties were dated 2 and 15 June 2005.

(3) Compared with direct sales by the appellant to the unrelated purchasers, not only was there no savings in costs, the group incurred extra costs of the assignments by the appellant to the immediate holding company of the 3 shops and the lavatory and a further $30,000 being the solicitor liquidator's costs of dealing with the section 45 stamp duty relief.

(4) After the sale to unrelated parties, there was no question of any running costs or 'redundant' operations, whatever 'redundant' was supposed to mean.

(5) The resolution for voluntary winding up was not passed until 23 December 2005.

59. We attach no weight to the letter dated 3 February 2005 from a limited company asserting that the open market value as at 31 December 2004 was $4,600,000 for the 15 June 2005 shops and $3,350,000 for the 2 June 2005 shop. There was no information upon which we can be satisfied on a balance of probabilities that that limited company or the one who signed it was qualified to give any expert opinion on valuation. Moreover, there was no indication how the values were arrived at and no comparable is mentioned.

60. In any event, the valuation of the 3 shops was as at 31 December 2004. By 30 May 2005:

(1) The appellant had received an offer to purchase the 2 June 2005 shop at $4,000,000, 19.4% more than the valuation at $3,350,000.

(2) The monthly rental for the 15 June 2005 had increased from $29,000 to $36,000, a 24% increase. Rental income for shops are relevant to their value.

61. We find as a fact that the transfer of the 3 shops from the appellant to its immediate holding company for $7,950,000 was, to the knowledge of the appellant and its immediately holding company, at an undervalue and that this was not an arms-length transaction.

62. We make the further finding that at the time of the internal transfer, both the appellant and the immediate holding company knew that the sales of the 3 shops to unrelated parties were imminent.

63. There is no evidence of any material increase in market value of the 3 shops between 30 May 2005 and 2 June 2005 or 15 June 2005. We find as a fact that the market value of the 3 shops as at 30 May 2005 was the same as the total of prices at which the 3 shops were sold to 2 related parties, that is, $10,400,000.

64. We also find as a fact that there was no commercial purpose for incurring extra costs and expenses for the internal transfer at what was known to be an undervalue. In any event, even if there was a commercial purpose, a transaction could also be 'tax driven'.

65. We shall consider the question of tax benefit in the following section.

Board's finding on the tax benefit

66. By the transaction as identified by the respondent, that is, by interposing the immediate holding company between the appellant and the related purchasers and by transferring the 3 shops from the appellant to the immediate holding company at a value of $2,450,000 below their market value, the appellant and the immediate holding company mopped up $2,450,000 of the appellant's profits. As seen from paragraph 20 above, the appellant had only $37,029 (that is, $121,850 - $84,821) left for set off against profits. However, the whole of $2,450,000 would be set off against the immediate holding company's loss brought forward.

67. We conclude that there was a tax benefit as contended by the respondent, i.e. the reduction in the amount of profits tax payable by the appellant resulting from the sale of its 3 shops at their book value as at 31 December 2004 of $7,950,000 instead of their market value at the time of sale of $10,400,000.

The 7 matters

68. We turn now to consider the various matters at (a) to (g) in section 61A(1).

The manner in which the transaction was entered into or carried out

69. The internal transfer was carried out with some haste or lack of care, evidenced by the omission of the lavatory in the assignment. There was no commercial purpose for the internal transfer at what was known to be an undervalue at a time when the sales to unrelated purchasers were, as the appellant and its immediate holding company knew, imminent. Additional costs were incurred when the asserted purpose (which we rejected) was to save costs.

70. The manner in which the transaction was entered into is strongly suggestive that:

(1) the appellant; and

(2) its immediate holding company;

entered into or carried out the transaction for the dominant purpose of enabling the appellant to obtain a tax benefit.

The form and substance of the transaction

71. The form of the transaction was the assignment of the 3 shops by the appellant to its immediate holding company, followed by the assignments of the 3 shops by its immediate holding company to the 2 unrelated purchasers.

72. The substance of the transaction is that the appellant obtained a tax benefit.

73. The form and substance in which the transaction was entered into is strongly suggestive that:

(1) the appellant; and

(2) its immediate holding company;

entered into or carried out the transaction for the dominant purpose of enabling the appellant to obtain a tax benefit.

The result in relation to the operation of the Ordinance that, but for section 61A, would have been achieved by the transaction

74. The result in relation to the operation of the Ordinance that, but for section 61A, would have been achieved by the transaction was that the appellant would have obtained the tax benefit as contended by the respondent and found by us in paragraph 67 above.

75. This is strongly suggestive that:

(1) the appellant; and

(2) its immediate holding company;

entered into or carried out the transaction for the dominant purpose of enabling the appellant to obtain a tax benefit.

Any change in the financial position of the relevant person that has resulted, will result, or may reasonably be expected to result, from the transaction; and any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant person, being a change that has resulted or may reasonably be expected to result from the transaction

76. As the internal transfer was at an undervalue, the appellant suffered a corresponding drop in income.

77. From the group's point of view, it made no difference as the appellant's immediate holding company acquired the 3 shops at a corresponding discount. It was simply a case of transferring group properties from one pocket to another. The transaction resulted in an unchanged financial position[27] for the group as a whole but in the conferment of a tax benefit on the appellant.

78. The group incurred extra costs and expenses arising from the internal transfer.

79. These 2 matters are strongly suggestive that:

(1) the appellant; and

(2) its immediate holding company;

entered into or carried out the transaction for the dominant purpose of enabling the appellant to obtain a tax benefit.

Whether the transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm's length under a transaction of the kind in question

80. The transaction was clearly not on arms length basis as it was an internal sale at what was known to be an undervalue. There was no commercial purpose for the interposition of the immediate holding company.

81. This matter is an important signpost and the uncommercial features of the transaction suggest that:

(1) the appellant; and

[27] This is subject to paragraph 78 below.

(2) its immediate holding company;

entered into or carried out the transaction for the dominant purpose of enabling the appellant to obtain a tax benefit.

The participation in the transaction of a corporation resident or carrying on business outside Hong Kong

82. There is no participation of any off shore company and this matter is irrelevant.

Dominant purpose

83. We must now look at the matters globally and arrive at an overall conclusion. By so doing we conclude that:

(1) the appellant; and

(2) its immediate holding company;

entered into or carried out the transaction for the dominant purpose of enabling the appellant to obtain a tax benefit.

Exercise of power under section 61A(2)

84. The respondent was bound under section 61A(2) to assess the appellant in such other manner as the respondent considered appropriate to counteract the tax benefit which would otherwise be obtained. We conclude that it was in order for the respondent to assess on the basis that the internal sale was at its market value of $10,400,000 to counteract the tax benefit which would otherwise be obtained.

The alternative transaction

85. As we have found in favour of the respondent on the transaction which the respondent identified, there is no need for us to consider the alternative transaction.

Conclusion and disposition

86. We dismiss the appeal and confirm the assessment appealed against.