Case No. D43/91

Profits tax – claim to deduct overseas taxes – shipping company – whether overseas taxes were outgoings incurred with a view to producing profits and in the production of profits – sections 16, 17 and 23B of the Inland Revenue Ordinance.

Panel: Robert Wei QC (chairman), William E Mocatta and Kenneth Ku Shu Key.

Dates of hearing: 27 and 28 June 1991.
Date of decision: 21 August 1991.

The taxpayer was a Hong Kong incorporated shipping company which owned and operated container ships which plied between Hong Kong, Australia, the Philippines, and Taiwan. The taxpayer was required to pay taxes in Australia, the Philippines and Taiwan. In Australia, the Philippines, and Taiwan, the taxes were an impost on the gross receipts relevant to the territory concerned. The taxpayer could not have carried on its business without paying the foreign taxes. Section 23B of the Inland Revenue Ordinance provides that tax is to be assessed on a specified percentage of 'total profits' as defined in that section. Section 23B requires the total profits to be ascertained in accordance with section 16(1) and section 17(1B) of the Inland Revenue Ordinance. The taxpayer claimed that the foreign taxes were deductible from its total profits because they were outgoings or expenses incurred in the production of the profits or for the purposes of producing such profits.

Held:

To the extent to which the overseas taxes were charged on gross receipts and not on net income, they were capable of being deducted when ascertaining the 'total profits' for the purposes of section 23B of the Inland Revenue Ordinance. The taxes on gross receipts in all three overseas countries were outgoings or expenses incurred in the production of profits within the meaning of section 16(1) and the same were not excluded by section 17(1B) of the Inland Revenue Ordinance. Accordingly, the taxes paid in Taiwan, the Philippines, and Australia were deductible but with regard to the Australian taxes in part only.

Appeal allowed in part.

Cases referred to:

The Union Steamship Company of New Zealand Limited v The Federal Commissioner of Taxation [1924] 35 CLR 209
John Davies v The Commissioner of Taxation (New South Wales) [1911]

13 CLR 197
Harrods (Buenos Aires) Limited v Taylor-Gooby 41 TC 450
Lo and Lo v CIR 2 HKTC 34
Morgan v Tate & Lyle Ltd (CA) [1953] 1 Ch 601
Morgan v Tate & Lyle Ltd (HL) [1955] AC 21
Usher's Wiltshire Brewery Ltd v Bruce [1914] 1 KB 357
AG v Ashton (CA) [1904] 2 Ch D 621
AG v Ashton (HL) [1906] AC 10
CIR v Swire Pacific Ltd 1 HKTC 1145
Yates v GCA International Ltd [1991] STC 157

Anthony Wu for the Commissioner of Inland Revenue.
Robert G Kotewall QC instructed by Messrs Johnson Stokes & Master for the taxpayer.

Decision:

1. This is an appeal by a taxpayer ('the Taxpayer') against the Commissioner of Inland Revenue's determination dated 10 November 1988 disallowing the deduction of certain overseas taxes paid by the Taxpayer in computing the total profits for the years of assessment 1976/77 to 1980/81 under section 23B of the Inland Revenue Ordinance.

2. The parties have agreed the following facts:

2.1 The Taxpayer was incorporated in Hong Kong as a private company. The nature of its business is 'shipping' and the principal activity is the operation of (and since 1979/80, the owning of) container ships for carriage of cargo between East Asia, South Korea (deleted since 1980/81), Southern and Eastern Australia as a liner service.

2.2 The Taxpayer also participated in certain operating arrangements with other shipping lines. An agreement with these lines provides for receipts and payments to be made in accordance with an agreed trade sharing formula. The calculation of these receipts is partly based on information obtained from these lines.

2.3 At all material times, the Taxpayer's issued and paid up capital was $250,000.

2.4 The Taxpayer owned a few container ships.

2.5.1 Each vessel sailed a circular route, being Hong Kong, Australia, the Philippines, Taiwan and Hong Kong and in each of these territories, the Taxpayer has an agent acting for it generally and to account to the respective revenue authorities for the tax which the Taxpayer has to pay in those jurisdictions.

2.5.2 In the Philippines, the Taxpayer has been licensed by the Securities and Exchange Commissioner to do business.

2.5.3 In Taiwan, the Taxpayer has made the relevant election with the Ministry of Finance under Article 25 of the Income Tax Law.

2.6 The relevant legislative provisions for the years in question are as follows:

(i) Australia

Section 129 of the Income Tax Assessment Act 1936 ('the Act')

> '129. Where a ship belonging to or chartered by a person whose principal place of business is out of Australia carries passengers, livestock, mails or goods shipped in Australia, 5% of the amount paid or payable to him in respect of such carriage, whether that amount is payable in or out of Australia, shall be deemed to be taxable income derived by him in Australia.'

'Taxable income' is defined in section 6(1) of the Act as including 'the amount remaining after deducting from the assessable income all allowable deductions'.

Section 17: Levy of Income Tax

> '17. Subject to this Act, income tax at the rates declared by the Parliament is levied, and shall be paid, for the financial year that commenced on 1 July 1965 and for each succeeding financial year, upon the taxable income derived during the year of income by any person, whether a resident or a non-resident.'

(ii) The Philippines

Article 25, Chapter III Title II Income Tax of the Philippine Internal Revenue Code

> 'SECTION 25. Rates of tax on foreign corporation –
>
> (a) Tax on resident foreign corporations – (1) in general – unless otherwise provided, a corporation organised authorized or existing under the laws of any foreign country, engaged in trade or business within the Philippines shall be subject to tax equivalent to 35% of the taxable

income derived in the preceding taxable year from all sources within the Philippines.'

Section 25(2) enacts the following:

'25(2) International carriers – International carriers doing business in the Philippines shall pay a tax of two and one-half per cent (2½%) on their "Gross Philippine Billings" as defined hereunder:

…

(B) International Shipping – "Gross Philippine Billings" means gross revenue whether for passenger cargo or mail originating from the Philippines up to final destination, regardless of the place of sale or payments of the passenger or freight documents.'

(iii) Taiwan

Article 25 of the Republic of China Income Tax Law

' Any profit-seeking enterprise having its head office outside the territory of the Republic of China, and which is engaged in international transport, construction contracting, providing technical services, or machinery and equipment leasing, etc., in the territory of the Republic of China, and the cost and expenses of which are difficult to calculate, may apply for approval from the Ministry of Finance, or the Ministry of Finance may make the decision to consider 10% of its total business revenue for an enterprise engaged in international transport business, or 15% of its total business revenue for one engaged in any other businesses as its income derived within the territory of the Republic of China regardless whether or not it has a branch office or business agent in the territory of the Republic of China. In such cases, however, the regulation in Article 39 regarding the deduction of losses cannot be applied.

Business revenue derived by an international transport enterprise within the Republic of China as provided in the preceding paragraph shall be as follows:

1. Marine Transport Enterprises:

> Referring to all ticket fares or transportation charges for outbound passengers and cargo accepted for carriage inside the territory of the Republic of China; …'

2.7 Taxes are paid by the Taxpayer in respect of its business activities in each of those jurisdictions in accordance with those provisions.

2.8 The actual outgoings and expenses incurred by the Taxpayer were not used in computing the profits to be brought into charge to tax in each of those jurisdictions.

2.9 The profits earned by the Taxpayer in each of those jurisdictions are included in the total profits as defined in section 23B of the Inland Revenue Ordinance. The assessable profits of the Taxpayer subject to profits tax in Hong Kong are:

$$\text{Adjusted total profits} \times \frac{\text{Hong Kong uplifts}}{\text{Worldwide uplifts}}$$

where:

Hong Kong uplifts are the aggregate of the sums receivable during the basis period for such year of assessment by the Taxpayer in respect of the carriage of passengers, mails, livestock and goods shipped in Hong Kong, in respect of outward towage undertaken from Hong Kong and in respect of charter hire other than charter hire attributable to a permanent establishment maintained by the Taxpayer outside Hong Kong.

Worldwide uplifts are the aggregate of the total sums receivable by the Taxpayer during that period in respect of the carriage of passengers, mails, livestock and goods, in respect of towage and in respect of charter hire.

2.10 The question for the Board of Review's determination is whether the taxes paid by the Taxpayer in each of those jurisdictions should be deducted in arriving at the total profits as defined in section 23B of the Inland Revenue Ordinance.

3. The Taxpayer called three foreign law expert witnesses. The first witness is an attorney at law licensed to practise in the courts of Taiwan and the senior partner of a law firm with offices in Taipei. He was admitted to the Bar of Taiwan over twenty years ago and is familiar with its laws including its tax laws. It is sufficient to quote the following paragraphs from his written statement which was read by him in his evidence-in-chief:

> '…
>
> 4. The effect of Article 25 of the Income Tax Law set out above is that if [the Taxpayer] elects to file an application and receives approval from

the Ministry of Finance, 10% of [the Taxpayer's] business receipts will be considered as taxable income. Corporate income tax at the rate of 25% would be applied to the 10% of the business receipts exceeding NT$100,000 resulting in an effective tax rate of 2.5%. This rate is applied to the turnover of [the Taxpayer] and not on net profits and the tax has to be paid whether or not any profits are realised by a company. The tax is a tax on turnover and not on profits. If a company actually made a loss as a result of carrying on business in Taiwan, it would not be entitled to ask the Ministry of Finance to revoke the approval given to it under Article 25 of the Income Tax Law except in the most extraordinary of circumstances and therefore its tax treatment would remain the same notwithstanding any change in the financial position of a company.

5. It has been mentioned to me that one reason why the rates of tax in the Republic of China are so low is that the effective rate of 2.5% takes into account any expenditure incurred by [the Taxpayer] in Taiwan with a view to generate the taxable income.

6. The relevant part of Article 24 of the Income Tax Law, which is the general provision, provides as follows:

> "The amount of income of a profit-seeking enterprise shall be the net income, that is the gross yearly income after deduction of all costs, expenses, losses and taxes."

7. The calculation of income subject to tax is set out in Article 31 of the Enforcement Rules of the Income Tax Law. Article 31 of the Enforcement Rules contains various formulas for calculating the income subject to tax and each type of business has to apply the rules as contained in Article 31. The rules in Articles 24 and 31 do not apply when dealing with companies such as [the Taxpayer] which fall within the provisions of Article 25 of the Income Tax Law.

8. The current Article 25 of the Income Tax Law replaced a previous Article 25 of the Income Tax Law which was first enacted in 1963. The 1963 version required the calculation of taxable income of the branch to be based on the "total income according to the proportion of the yearly business revenue of such branch office to the total business revenue of a company's worldwide operation". The method used in this 1963 version for determining taxable income involved complicated procedures and extensive logistical considerations and presented tremendous difficulties for the tax administration and the collection of the tax itself. The calculation was so time consuming that it rendered the year end filing of an income tax return before the end of March (the end of December being the end of the fiscal year in Taiwan) virtually impossible.

9. In order to remedy the defects of the 1963 version of the Income Tax Law, the 1979 version quoted above was introduced. The 1979 version incorporated the specially favoured formula for the determination of taxable income (being 10% of total business receipts) and this was not only applicable to international transport enterprises but also to international construction contracting, technical service and machinery and equipment leasing (otherwise known as "other businesses").

10. The Taiwanese revenue authorities have the power of attaching any assets which [the Taxpayer] may have in Taiwan. However, the Taiwanese revenue authorities are not empowered to impose specific sanctions in the Republic of China against international transport enterprises such as [the Taxpayer]. The Income Tax Law does not prescribe any specific sanctions on companies such as [the Taxpayer] when it fails to settle its taxation liabilities due to the Taiwanese revenue authorities.

11. As a matter of practice, such sanctions or attachments would not be necessary. According to the Income Tax Law, for a company such as [the Taxpayer] without a formal presence in Taiwan which, in general terms, is a company which neither holds Republic of China Foreign Company Recognition Certificate nor maintains a local branch in Taiwan but which maintains a business agent in the Republic of China, the business agent is obliged to withhold the tax from the freight it collects for or on behalf of [the Taxpayer]. The agent then pays the tax to the Taiwanese revenue authorities. Failure to do so will result in a personal liability against the agent for payment of the tax and a fine. In principle, the interests of the Taiwanese revenue authorities are protected despite the lack of provision for specific sanctions or attachments against companies such as [the Taxpayer]. As a matter of Taiwanese law, the agent of [the Taxpayer] situated in Taiwan would be able to recover from [the Taxpayer] any tax which [the Taxpayer] had failed to pay to the revenue authorities in the Republic of China.

12. It is quite clear from the above that the tax payable by [the Taxpayer] in Taiwan is a tax chargeable on turnover of the company in Taiwan and not on its net income ...'

In cross-examination, the first witness stated that taxable income is not net income under Article 25. One can apply for assessment under Article 24 or 25 each year, and the revenue authority will grant such an application; in practice, however, one does not elect for assessment under Article 24 in view of the advantage afforded by Article 25 as long as there is a profit to make. The rate of 25% applies to net income under Article 24 and to 10% of gross receipts under Article 25. The 2.5% of gross receipts under Article 25 must be paid whether one makes a profit or not. If a shipowner fails to pay tax, the authorities can attach freight. In re-examination he stated that the authorities can also arrest its ships. The

Ministry of Finance will grant approval for an election once it is made, and can treat 10% of gross receipts as taxable income without any application.

4. The second witness was admitted to the Philippine Bar in 1972. He was a judicial assistant to a justice of the Philippines before he joined a law firm of which he is a partner. His practice extends to the special field of taxation where he renders opinions and studies on tax problems of his clients and handles their tax cases and assessments from the administrative level to the courts. His written statement which he read out in his evidence-in-chief states in part the following:

> '…
>
> 4. The tax charged by the Philippine Internal Revenue Code ('the Code') is a tax charged on the gross receipts of international carriers. In effect, the tax is a tax on turnover and does not take into account any expenditure incurred by [the Taxpayer] as a result of carrying on business in the Philippines. The tax must be paid even if [the Taxpayer] makes a loss and has no profits.
>
> 5. [The Taxpayer], as an international carrier engaged in trade or business in the Philippines pays a straight tax at the rate of 2.5% on its gross billings and it is not entitled to deduct from its gross income any expenditure.
>
> 6. If [the Taxpayer] did not pay or refused to pay a properly raised tax demand by the Philippine Internal Revenue Authorities, the sanctions which the Commissioner of Internal Revenue could impose against any delinquent taxpayer are of two categories:
>
>   (1) the civil remedy which is by distraint on the seizing of personal property of [the Taxpayer] and by imposing a levy upon the real estate of [the Taxpayer] which may be situated in the Philippines.
>
>   (2) by raising criminal proceedings against [the Taxpayer] (section 205, National Internal Revenue Code).
>
> 7. The Commissioner of Internal Revenue has the power to follow both processes set out above at the same time. If [the Taxpayer] did not settle the Philippine tax due and a ship belonging to [the Taxpayer] called in at a port in the Philippines, the Commissioner of Internal Revenue is able to arrest the ship, arrange for its sale and collect the outstanding tax from the sale proceeds under the remedy of distraint.
>
> 8. Further, if [the Taxpayer] failed to pay the tax, it would have to pay a 25% surcharge (section 248 [a]) which may be increased to the "fraud penalty" of 50% if there is wilful neglect or fraud or false returns made to

the Internal Revenue Service (section 248 [b]). Further, interest at the rate of 20% (section 249) is payable on the amount due. Failure to file information, returns, statements or lists or to keep records required by the Code subjects the delinquent taxpayer to a fine of P1,000 for each failure but the aggregate amount for all such failures not to exceed the total of P25,000 to each calendar year (section 250). Violations of acts or omissions penalized under the Code like evasion of tax (section 253) and failure to file return (section 254), constitute criminal offenses and subject the offenders to fine or imprisonment, or both. In the case of the corporations, the penalties shall upon conviction be imposed on the manager of person responsible for the violation which may include deportation if the offender is not a Filipino citizen (section 252) and in addition to the penalties imposed upon the responsible corporate officers, the corporation shall be fined not less than P10,000 but not more than P100,000 for each act or omission (section 255).

9. A foreign corporation doing business in the Philippines must have a licence from the Securities and Exchange Commissioner ("SEC"). In order for the licence to be cancelled, proceedings must be taken before the SEC. Assuming [the Taxpayer] has a licence to do business, the SEC may revoke its licence for "failure to pay any and all taxes, imposts, assessments or penalties, if any, lawfully due to the Philippine Government or any of its agencies or political sub-divisions" (section 134, paragraph 6, Corporation Code of the Philippines). And as a practical matter, the Commissioner of Internal Revenue could indirectly force [the Taxpayer] to cease doing business in the Philippines if [the Taxpayer] failed to pay tax by arresting ships which called into Philippine ports, arresting or seizing other property of [the Taxpayer] in the Philippines or deporting the responsible management of [the Taxpayer] if they were not Filipino citizens.'

In cross-examination, the second witness stated that taxable income under section 25(1) is net income while section 25(2) imposes a straight tax on the gross Philippine billings so that one does not work out a taxable income under section 25(2). He did not agree with the suggestion that gross Philippine billings is in the spirit of taxable income. In answer to a member of the Board, he stated that section 25(1) and (2) are mutually exclusive. The civil proceedings referred to in paragraphs 6(1) and 7 of his evidence-in-chief are summary proceedings which may be taken without going to court.

5. The third witness is an Australian who was admitted to the bar of South Australia and New South Wales in 1986 and 1990 respectively. He has been employed in the tax department of a firm of solicitors since early 1989 and has specialised in Australian tax law since 1986. His written statement which he read out in his evidence-in-chief states in part as follows:

'…

4. There are certain cases in Australia which have considered that a tax such as that imposed by section 129 of the Income Tax Assessment Act 1936 ("the Act") is a tax on turnover and not on net profits. I refer to the case of The Union Steamship Company of New Zealand Limited v The Federal Commissioner of Taxation [1924] 35 CLR 209 where the full High Court considered section 22 of the Income Tax Assessment Act 1915-1918, the predecessor to section 129 of the Act.

Section 22 provided, inter alia:

> "(1) Every person whose principal place of business is out of Australia and who either as owner or charterer of any ship carries passengers, livestock, mails or goods shipped in Australia shall by his agent ... make a return of the full amount payable to him ... in respect of the carriage ...
>
> (2) The agent shall be assessed thereon and liable to pay tax on 10% of the amount so payable."

Knox, C J (ibid at page 215) said that:

> "It is clear that the proportion of the gross receipts of the taxpayer on which tax is made payable by this section is an arbitrary amount which bears no necessary relation to the profits made by the taxpayer on the transaction from which the gross receipts are derived, and may either be greater or less than the amount of such profits. The amount is the same whether such transaction result in profits available for distribution to shareholders or in a loss."

The court held that the tax was payable on the gross amount receivable and that the taxpayer was not entitled to deduction in respect of an amount which otherwise would have been deductible from assessable income.

5. In the case of John Davies v The Commissioner of Taxation (New South Wales) [1911] 13 CLR 197, consideration was given to the application of section 23 of the Land and Income Tax Act 1895. That section imposed tax in a similar manner to section 22 which was considered in the case of The Union Steamship Company of New Zealand Limited v The Federal Commissioner of Taxation. Section 823 of the Land and Income Tax Act 1895 provided as follows:

> "... the taxable amount of the income derived ... by the principal shall be assessed as an amount equal to 5% of the total amount received for such goods ..."

Griffiths, C J (ibid at page 209) stated that:

> "In section 23, 'the taxable amount of the income derived by the principal' does not depend upon any calculation or deduction. It is fixed by an arbitrary rule, 5% of the gross receipts ..."

The majority of the court (Griffiths C J and O'Connor J) held that the taxable amount of the income derived by the principal did not depend on any calculation or deduction and that the taxpayer was not entitled to any deductions from the amount calculated in accordance with section 23.

6. It is my view from the above cases that section 129 of the Act operates to impose tax at the rate of 5% upon the gross amount payable in respect of the carriage of the relevant goods shipped in Australia and does not permit the deduction from the gross amount of otherwise deductible expenses. This is to be contrasted with section 135A which provides for a deduction in respect of a rebate for goods shipped under an agreement specified in the Australian Industry Preservation Act 1906-1937 but in my view, section 135A is quite specific and does not affect the relevance of the cases mentioned above or [the Taxpayer's] tax liability in Australia. Therefore, the tax imposed by section 129 is to be properly characterized as a tax upon the gross receipts or turnover of the company rather than as a charge upon the net income of the company.

7. There has been a suggestion that the reason why the rate of tax imposed in Australia is so low is that some allowance has been made for the expenses incurred by [the Taxpayer] or such other companies which may carry on business in Australia and be subject to special rules which tax turnover as opposed to net profits or income.

8. In general terms, Australian tax is payable on the taxable income of a taxpayer which is calculated as assessable income less all allowable deductions. This is provided for by section 6 of the Act. Where a taxpayer is not a resident, assessable income includes gross income derived from all sources within Australia. Deductions are allowed for expenditure to the extent to which it is incurred in producing assessable income or in carrying on a business for the purpose of producing such income. I refer to section 51(1) of the Act.

> "51(1) Deductions for losses and outgoings
>
> All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing such income, shall be

> allowable deductions except to the extent to which they are losses of outgoings of capital, or of a capital, private or domestic nature, or are incurred in relation to the gaining or production of exempt income."

Section 129 was enacted as part of the original 1936 Act and has remained in the same terms since its enactment. The section operates to tax Australian sourced income of shipowners or charterers whose principal place of business is outside of Australia. By contrast with the general structure of the Act which looks to assessable income and allowable deductions, the mechanism adopted to tax such income as shall be earned by companies such as [the Taxpayer] is to deem an arbitrary percentage, in this case 5%, of the gross receipts received in respect of the carriage of goods or persons from Australia to be taxable income. That amount is then subject to tax at the usual rate, currently 39% for companies. The effective rate of tax for a company which falls within section 129 is, therefore, 39% of 5% giving a total of 1.95% of the gross amount payable to the owner or charterer.

9. The regime was clearly chosen to overcome the difficulty of taxing non-resident shipowners and charterers. I should perhaps mention that section 143 of the Act deals with non-resident insurers in a similar manner by deeming 10% of premiums payable to a non-resident insurer to be taxable income of the insurer. Section 143 of the Act may be contrasted with section 129, however, in that it provides that where the actual profit or loss made by the insurer in respect of such premiums is established to the satisfaction of the Commissioner of Taxation, the taxable income or the loss is calculated by reference to the actual receipts and expenditure. Therefore, section 143 contains a mechanism for the deduction of expenditure whereas section 129 makes no reference to deductions or allowable expenditure.

The Union Steamship Company of New Zealand Limited v The Federal Commissioner of Taxation and John Davies v The Commissioner of Taxation (New South Wales) clearly establish that the tax imposed by section 129 of the Act is a tax on gross income or turnover as no deduction from the 5% amount is available to the taxpayer. Furthermore, the tax is payable whether or not the taxpayer actually derives any profits. In other words, the tax is payable even if [the Taxpayer] makes a loss in carrying on business in Australia.

10. In real terms, the tax is levied on the gross income of shipowners and therefore for the above reasons falls within the principles in Harrods (Buenos Aires) Limited v Taylor-Gooby 41 TC 450.

I have undertaken research with regard to the legislative intent of section 129. There has been no statement that I have been able to locate in Australia by Australian treasury officials or any member of the Australian Government in the House of Parliament to the effect that when fixing the level of tax, consideration has been taken with respect to allowable deductions.

11. I have noted from the case of Harrods (Buenos Aires) Limited v Taylor-Gooby that stress was laid as to the sanctions which could have been taken against Harrods (Buenos Aires) Limited had that company failed to settle the capital duty payable in the Argentine. In Australia, the main emphasis of the taxation system is on self assessment and section 129 is a deeming provision. Therefore, under the general self assessment regime, a taxpayer has an obligation to lodge an annual income tax return and pay tax on the relevant 5% taxable income. To combat the general collection difficulties which the Commissioner has in respect of non-Australian based or resident taxpayers, there is a broad provision in section 254 of the Act that effectively allows the Commissioner to collect tax due from any person who is an agent of trustee of the relevant taxpayer in Australia from any monies which comes to that agent of trustee in their respective capacities. There are similar provisions contained in section 255 of the Act that generally allow the Commissioner to recover tax due by non-resident from any person having the receipt control or disposal of money belonging to that non-resident. There are also specific recovery provisions that relate to income deemed to be taxable under section 129 quoted above.

12. Therefore, if [the Taxpayer] failed to settle the tax due in respect of the deemed income arising under sections 129, 130, 131 and 132 of the Act effectively operate to allow the Commissioner to assess and require payment of the tax from either of the master of the relevant ship or any agent or other representatives in Australia of [the Taxpayer]. If the tax assessed was not paid forthwith, a personal liability for that tax would fall upon the master of the relevant ship (section 133(1)) but the person actually assessed to tax would remain liable as well (section 133(2)). Section 135 also requires a Customs officer of any relevant Australian state or territory to withhold clearance of the relevant ship until the section 129 tax has been paid or that arrangements for its payment have been made to the satisfaction of the Commissioner of Taxation.

13. The Commissioner's recovery powers under sections 132 and 133 are broader than under the general provisions of sections 254 and 255. This is because under the former provisions, the Commissioner need only to identify and then assess the master of the relevant ship or any agent or other representative of the person deemed to have derived income under section 129.

Generally, where tax is assessed upon a person under the Act and that taxpayer fails to pay the tax within the time notified within the assessment, the unpaid tax becomes a debt due to the Commonwealth and payable to the Commissioner. Unpaid tax attracts penalty tax at the rate of 20% per annum which penalty tax is also a debt due to the Commonwealth and payable to the Commissioner. The Commissioner also has the power to sue for the recovery of any tax unpaid immediately after the expiry of the time when it becomes due and payable. Upon obtaining judgment for the debt, the Commissioner generally ranks as an ordinary unsecured creditor of the relevant taxpayer which means that on a winding up of the taxpayer, the Commissioner will not have a priority over the assets of the taxpayer.

14. In general terms, if [the Taxpayer] had an obligation to pay tax arising as a result of the operation of section 129 which it did not meet then,

(1) the relevant ship giving rise to tax liability could be impounded until the tax was paid or suitable arrangements made for its payment;

(2) the Commissioner could seek to recover the tax from either the master of the relevant ship or any other representative or agent of [the Taxpayer] in Australia;

(3) the Commissioner could eventually sue [the Taxpayer] and the person assessed for unpaid tax and brought proceedings to have those debtors liquidated in order to meet the judgment debt obtained.

Whilst none of the foregoing remedies available to the Commissioner would force [the Taxpayer] to cease carrying on business in Australia, they would ultimately have the effect of so doing over a period of time.

15. To sum up, the position in Australia is that the tax payable is a tax on turnover, not net income of [the Taxpayer] for the reasons given above.'

In cross-examination the third witness stated that there was no provision in section 22 of the Income Tax Assessment Act 1915-1918, to the best of his knowledge, whereby the 10% of the amount payable to the Taxpayer in respect of the carriage, etc was deemed to be taxable income, but The Union Steamship case is still persuasive and of relevance. When asked by the Board whether by reason of the deeming provision in section 129 of the Income Tax Assessment Act 1936, the 5% of the amount payable assumes the character of a net income, he answered 'no'. He stated that any tax imposed by the 1936 Act is called income tax. Under section 129 the amount to be taxed is a gross amount. The deeming provision makes that amount taxable. In answer to the Board, he stated that a

taxpayer to whom section 129 applies cannot opt out of that section, even if he is making a loss. Returns can be required on a voyage by voyage basis so that taxes are paid on those returns. The law requires the filing of returns as often as may be required. There is a section which requires taxpayers to make returns annually, but the Commissioner may at his discretion require more frequent returns. The tax recovery provisions referred to in paragraphs 11, 12 and 13 of his written statement apply to all taxes. In answer to questions from the Board, he stated that in his opinion section 129 does not apply to a hirer of containerable spaces. It was his understanding that the Australian Taxation Office, when dealing with a hirer of containerable spaces, looked to the general provisions rather than the specific provisions of section 129 as a matter of administrative policy.

6. We accept the evidence of the three foreign law experts in total. We find that in each case the foreign tax was an impost on the gross receipts relevant to the territory concerned whether or not profits are earned. The tax is quantified in Taiwan and Australia by taking a specified percentage of a fixed proportion of the gross receipts, while the Philippine tax is simply a specified percentage of the gross receipts. In Taiwan the tax is considered to be taxable income, whereas in Australia it is deemed to be so. However, on the clear evidence of all the three experts that the taxes were in each case a tax on turnover as opposed to net income, we are of the view that the 'taxable income' treatment in Taiwan and Australia is but a mechanism, a device to subject to tax the amount representing the fixed proportion of the gross receipts, and does not change the fact that the tax is imposed on the gross receipts before any deduction is made in respect of outgoings or expenses. This paragraph is subject, however, to what we have to say below regarding the position of the Taxpayer as a hirer of containerable spaces in relation to the Australian tax.

7. We further find that in all three cases, the Taxpayer could not have gone on earning income without paying the foreign taxes. Directly or indirectly, the imposition of the sanctions available to the authorities would have forced the Taxpayer to cease its operations. Those sanctions are mentioned in the experts' statements quoted in paragraphs 3, 4 and 5 above.

8. The expression 'total profits' is defined in section 23B of the Ordinance as follows:

> ' "total profits" for any period means the world profits of a person from his business as an owner [including a charterer] of ships as shown by his accounts for such period:
>
> Provided that where the said total profits have been computed on a basis which differs materially from that prescribed in this part for the ascertainment of assessable profits in respect of which a person is chargeable to tax, such profits shall be adjusted so as to correspond as nearly as may be to the sum which would have been arrived at had they been computed in accordance with the provisions of this part relating to the ascertainment of assessable profits in respect of which a person is chargeable to tax.'

As the total profits are adjusted total profits (refers to paragraph 2.9 above), it is necessary to compute the total profits in accordance with the relevant provisions of part IV of the Ordinance, that is, sections 16(1) and 17. Section 16(1) reads as follows:

> '16(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 ...'

The word 'including' is followed by a list of permitted deductions. Section 17 prohibits the deduction of certain outgoings and expenses; in particular section 17(1)(b) provides as follows:

> '17(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 –
>
> …
>
> (b) any disbursements or expenses not being money expended for the purpose of producing such profits;
>
> …'

Of the deductions permissible to be made under sections 16 and 17, Lord Brightman in the Privy Council had this to say in Lo and Lo v CIR 2 HKTC 34 at 71:

> '... such permitted deductions expressly include those specified in (a) to (h) of section 16(1), and expressly exclude those in section 17. In the opinion of their Lordships commercial considerations are not wholly to be disregarded in the course of this process. They are relevant for the purpose of deciding what can properly be treated as "outgoings and expenses ... incurred during the basis period ... in the production of profits in respect of which" the taxpayer is chargeable to tax.'

In the Court of Appeal, Cons, J A, as he then was, said at 67:

> 'The vital difference between the jurisdictions, as I see it, is merely that in Australia what is appropriate by way of deduction is decided in the last resort by the judges applying statutory standards, whereas in England it is judged by the standards set by the accountancy profession, subject of course to any particular overriding legislation. In my opinion Hong Kong falls within the latter pattern for although there are some particular instances set out in sub-section 16(1) those instances are introduced by the word "including". That

> implies that there must be other deductible items which have not been specifically mentioned, and how are these to be found except by reference to normal accountancy practice, provided of course that they do not contravene the general words of the sub-section.'

Leonard, V P said at 63:

> 'Section 16 may then be paraphrased to read:
>
> > "In order to ascertain the taxable profits you shall deduct from the total of receipts and sums deemed to be receipts all outgoings and expenses to the extent to which they are incurred in the production of such profits."'

And then at 64:

> ' One must ... ascertain the expenses to be deducted (from receipts) ... upon ordinary business accounting considerations.'

9. Jenkins, L J commented on the process of deducting expenditure from gross receipts in this way in Morgan v Tate & Lyle Ltd [1953] 1 Ch 601 at 627:

> ' It has long been well settled that the effect of these provisions as to deductions is that the balance of the profits and gains of a trade must be ascertained in accordance with the ordinary principles of commercial trading, by deducting from the gross receipts all expenditure proper deductible from them on those principles, save in so far as any amount so deducted falls within any of the statutory prohibitions contained in the relevant rules, in which case it must be added back for the purpose of arriving at the balance of profits and gains assessable to tax. See Usher's Wiltshire Brewery Ltd v Bruce, per Lord Loreburn, Lord Parker of Waddington, Lord Sumner, and Lord Parmoor.'

That comment by Jenkins, L J was approved by Lord Morton of Henryton in the House of Lords in the same case [1955] AC 21 at 36. The statutory provisions referred to by Jenkins, L J were those in rule 3 of the rules applicable to cases I and II of schedule D to the Income Tax Act, 1918 (corresponding to section 74 of the Income and Corporation Taxes Act 1988, part V). Rule 3(a) under the 1918 Act (now section 74(a) of the 1988 Act) reads:

> '3. In computing the amount of the profits or gains to be charged, no sum shall be deducted in respect of –
>
> (a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment or vocation …'

10. The non-statutory principles or considerations spoken to by the judges have been described by them in varying terms as shown above, but they all concern the question of making deductions from the gross receipts in drawing up the profit and loss account. In

AG v Ashton [1904] 2 Ch D 621, Buckley, J stated two principles concerning the question of making deductions which were relied on by Mr Kotewall, Counsel for the Taxpayer, for saying that the foreign taxes in question are deductible. In the Ashton case, the question was whether in calculating the rate of dividend, income tax payable on the profits should be included in the profits. At 624 Buckley, J had this to say:

> ' 'The profits are not arrived at after deducting income tax. The income tax is part of the profits – namely, such part as the Revenue is entitled to take out of the profits. A sum which is an expense which must be borne whether profits are earned or not, may no doubt be deducted before arriving at profit. But a proportionate part of the profits payable to the Revenue is not a deduction before arriving at, but a part of, the profits themselves.'

The two principles establish respectively (1) the unavailability of income tax as a deduction and (2) the deductibility of expenses which must be borne whether or not profits are earned. They are approved in the Court of Appeal at 627, 629 and 630 and in the House of Lords in [1906] AC 10 at 12, 13 and 14. Mr Kotewall also referred to Willoughby's Hong Kong Revenue Law, vol 2, section 16, 2-259 where it says:

> ' However, as a matter of general principle a foreign tax is also deductible if it is a charge on earnings and is payable whether or not a profit is made. This may be particularly relevant in the case of shipping companies assessed on a proportion of their total world profits under section 23B or 23C. In an unreported Board of Review case it is understood that Indian freight tax and Canton Government tax were held deductible in ascertaining the chargeable profits of a shipping company. The general principle was stated by Buckley, J in AG v Ashton [1904] 2 Ch D 621 at 624 in these words:
>
> > "A sum which is an expense which must be borne whether profits are earned or not, may no doubt be deducted before arriving at profit."'

We can confirm the existence of that unreported Board of Review case and have to point out that the word 'Canton' in the extract from Willoughby's Hong Kong Revenue Law should read 'Cuban'. Relying on the same principle, Mr Kotewall submitted that in the present case, since all three foreign taxes are imposts on gross receipts and must be paid whether profits are earned or not, they are deductible. We accept his submission, but subject to reservations with regard to the Australian part of his case as we shall explain in the next paragraph.

11. The Taxpayer's case concerning the Australian tax is founded on section 129 of the Australian Act. Section 129 is not applicable to a hirer of containerable spaces (see summary of the third witness' testimony towards the end of paragraph 5 above). It follows that if by reason of the Taxpayer's position as a hirer of containerable spaces, any part of the Australian tax was assessed under some provisions other than those of section 129, that part of the tax has not been shown to be deductible, and that to that extent the appeal cannot succeed.

12. Mr Wu, Counsel for the Commissioner of Inland Revenue, submitted that the Ashton case should be read in its context, but his main points are the following, as summarised in his skeleton submission:

(1) The taxes in question seek to tax net income (accretion to economic power).

(2) The percentages are only special formula for ascertaining the amount of net income for tax.

(3) The taxes paid are an application of profits.

The first two points are covered by our views stated in paragraph 6 above. As for the third point, in our view precisely the opposite is true: the taxes are part of the gross receipts and are paid out of them before any deduction is made for profit and loss account purposes – they are not part of, nor paid out of, the profits which are arrived at after all permitted deductions have been made – there is no room for any application of profits, for no profits are in actual fact applied.

13 Mr Wu submitted that there was an inconsistency in the Taiwan law expert's evidence: in paragraph 4 of his written statement, he states that the Taxpayer would not be entitled to ask the Ministry of Finance to revoke the approval given under Article 25 except in the most extraordinary circumstances while in cross-examination and re-examination he stated that the Taxpayer can apply for assessment under Article 24 or Article 25 each year and that the revenue authority will grant the application once it is made. We think that the inconsistency is more apparent than real, and we agree with Mr Kotewall that in chief the witness was referring to an application for assessment under Article 24 after a loss has been made. In any event the Taxpayer did not apply for revocation of its election under Article 25 throughout the accounting period (see paragraph 2.5.3 above).

14. Mr Wu drew our attention to the comment of Cons, J A in the Lo and Lo case on the difference between the phrase 'for the purposes of the trade, etc' in the United Kingdom legislation and the phrase 'in the production of profits, etc' in our section 16(1). Cons, J A said this at page 66:

> ' "In the production of profits, etc" is from the taxpayer's point of view, a more narrow exception than "for the purposes of the trade, etc", and I do not think much assistance could be drawn from any English case that dealt with the latter phrase; however, we are not concerned with that aspect.'

That comment, albeit obiter, requires careful attention, and has led us to these considerations:

(a) it applies, we think, to the phrase 'for the purpose of producing such [that is, chargeable] profits' in section 17(1)(b) as well as to the phrase 'in the production of profits etc'; section 17(1)(b) has been regarded as a negative way

of putting the rule in the opening words of section 16(1) (Willoughby's Hong Kong Revenue Law, vol 2, section 17, 2-280);

(b) given comparable circumstances, an expense which is within the meaning of the United Kingdom phrase may or may not be within the meaning of the Hong Kong phrases;

(c) given comparable circumstances, an expense which is outside the meaning of the United Kingdom phrase is also outside the meaning of the Hong Kong phrases;

(d) subject to the foregoing, in any given case in deciding whether an outgoing or expense is within the meaning of the Hong Kong phrases, one must be guided by the true construction of these phrases, taking into account principles of a commercial or accounting nature.

15. Turning to the question of construction, we do not think that the Hong Kong phrases mean that to be deductible, an outgoing or expense must by itself produce profits, for profits are produced by the operation of the Taxpayer's trade or business as a whole; nor, for that matter, can it produce gross receipts by itself, for, being money which is paid out, no outgoing or expense can do that. It seems to us that an outgoing or expense is a step towards producing gross receipts and profits. In CIR v Swire Pacific Ltd 1 HKTC 1145, the question was whether payment of retirement grants to workers to end their strike was deductible expenditure. In holding it deductible, Yang, J, as he then was, said at 1160:

> 'However, under section 16(1) of the Ordinance expenditure in the course of business which is unremunerative is none the less a proper deduction if made with a view to producing profit.'

Those words were cited with approval in the Court of Appeal at 1170 by Leonard, J, as he then was, who then said at the same page, 'I therefore hold that section 17(1)(b) of the Ordinance does not forbid the deduction of the payment'. We think that the phrase 'with a view to producing profit' supports the view that an outgoing or expense is a step towards the production of profits.

16. We are not aware of any United Kingdom case which decided or considered a question of a foreign tax on gross receipts in relation to the phrase 'for the purposes of the trade'. The nearest case appears to be Harrods (Buenos Aires) Ltd v Taylor-Gooby 41 TC 450 where a company incorporated and resident in the United Kingdom and carrying on business in Buenos Aires was liable to a tax which was charged annually at the rate of 1% on the company's capital and was payable whether or not there were profits liable to Argentine income tax. Under Argentine law there were sanctions available to remedy non-payment of the tax, and the imposition of such sanctions would render it virtually impracticable, if not wholly impossible, for the company to continue trading. It was held that 'the payment of the tax was a disbursement wholly and exclusively laid out or expended for the purposes of the trade of the company, and as such was properly deductible

in computing the profits or losses of the company' (per Willmer, L J at 467)(emphasis is ours). Mr Kotewall referred to the case of Yates v GCA International Ltd [1991] STC 157 where it was held that the taxpayer was entitled to unilateral double taxation relief by way of credit in respect of the payment of a Venezuelan tax (on 90% of the gross receipts attributed to services performed by the taxpayer in Venezuela) against United Kingdom corporation tax. One of the conditions for entitlement to relief was that the foreign tax should correspond to income or corporation tax in the United Kingdom. Scott, J said at 168:

> 'The main plank of counsel for the Crown's argument was that Art 54 constitues a tax on turnover and that a tax on turnover does not correspond to United Kingdom income tax or corporation tax. It is true that a tax assessed on a percentage of gross receipts may be subjecting to tax a loss-making business, and to that extent is dissimilar from a tax on profits or gains of a business.'

Mr Kotewall stated that he was referring to that case for the purpose of showing that the court recognised a difference between a tax on gross receipts and one on profits or gains. Scott, J then said at 169:

> 'The intention of each of these articles (of the Venezuelan tax code), evidenced from the language used therein, is to charge "net profits". That expression is used in each of the chapter IV articles. To the extent that Art 54 and the other articles seek to charge net profits to income tax, they are, in my judgment, serving the same function as income tax and corporation tax serve in the United Kingdom in relation to the profits of a business carried on by an individual or by a company, as the case may be.'

Article 54 reads:

> 'The net profits of the taxpayers not resident or not domiciled in Venezuela, originating from non-commercial professional activities, will be constituted by ninety per cent (90%) of the amount of their gross receipts ...'

Mr Kotewall submitted that the facts, the law and the issues in that case were all different from those in the present case, and that no assistance could be obtained from it. We agree. Superficially the words used in the passage quoted from page 169 of Yates v GCA International Ltd above bear some resemblance to some of the arguments advanced by Mr Wu, but Mr Wu did not rely on that passage, nor did he refer to that case in his submission. We think Mr Wu was right not to rely on that case. It turned on the peculiar wording of the Venezuelan tax law which in effect says that net profits are x% of gross receipts. In deciding whether the Venezuelan tax corresponded to the United Kingdom income tax or corporation tax, the judge took into account the intention of the Venezuelan law to charge net profits and the Venezuelan tax serving the same function as income tax or corporation tax, whereas in the present case we are concerned with the ascertainment of total profits in accordance with the provisions of sections 16(1) and 17(1)(b) of the Ordinance; those provisions permit the taxpayer to make all proper deductions against the gross receipts and to take the balance thus arrived at as his taxable profit or loss as the case may be; in the

scheme imposed by section 16(1), there is no room for assuming the gross receipts or a fixed proportion of them to be profits, or assuming a tax on the former to be a tax on the latter, for profits are to be found, not by assumption, but by ascertainment in accordance with the expenditure deducting process prescribed by the opening words of section 16(1). In our view, the Yates case is irrelevant for present purposes.

17. In the present case, we are satisfied that the Taxpayer could not have gone on earning income without paying the foreign taxes and that the foreign taxes must be paid whether or not profits were earned, and we conclude that the taxes were paid with a view to producing profits and were outgoings incurred in the production of profits within the meaning of section 16(1) of the Ordinance and that the payment of the taxes was not prohibited by section 17(1)(b) of the Ordinance. Our decision is as follows:

(a) That the Taiwan and Philippine taxes are deductible, and that this appeal succeeds with regard to those taxes.

(b) That the Australian tax is deductible, but only so far as it was assessed under section 129 of the Australian Act, and that to that extent this appeal succeeds with regard to the Australian tax, and that this case be remitted to the Commissioner for the purpose of ascertaining the amount of the Australian tax which was assessed under section 129 of the Australian Act, with liberty to either party to restore this case in case of disagreement.