INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D46/88

Profits tax – deductions – acquisition of unregistered trade mark – whether expenditure deductible – s 16E of the Inland Revenue Ordinance.

Profits tax – deductions – acquisition of design – whether design is a trade mark – s 16E of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Chiu Chun Bong and Gerald C Dobby.

Date of hearing: 30 August 1988.
Date of decision: 2 November 1988.

In October 1980, the taxpayer company took over a business which had been operated by its shareholders in partnership. In July 1983, section 16E of the Inland Revenue Ordinance was enacted in order to permit a deduction to be taken for the acquisition cost of trade marks. In order to take advantage of this new provision, an agreement was entered into in December 1983 whereby the previous partners sold the trade mark under which they had previously carried on business to the taxpayer. In fact, the taxpayer had been using the trade mark all along without any objection from the partners.

The trade mark was not registered.

The IRD disallowed the taxpayer's claim to a deduction for the cost of the trade mark. The taxpayer appealed.

Held:

The cost of the trade mark was not deductible.

(a) Section 16E permits a deduction for the cost of both registered and unregistered trade marks.

(b) Section 16E does not permit a deduction for the cost of a design. (However, since the mark in this case constituted a trade mark, nothing turned on this.)

(c) On the facts, ownership of the trade mark had passed to the taxpayer when the taxpayer took over the partnership's business in 1980. The agreement of 1983 which purported to sell the trade mark to the taxpayer therefore had no effect.

Appeal dismissed.

Cases referred to:

American Greetings Corp's Application, re [1984] 1 All ER 426
Cape Brandy Syndicate v IRC [1921] 1 KB 64
CIR v Howe (1977) 1 HKTC 936
Erven Warnink BV v J Townend and Sons (Hull) Ltd [1979] AC 731
FCT v Just Jeans Pty Ltd (1987) 87 ATC 4373
Pink v J A Sharwood and Co Ltd (1913) 30 RPC 725
Pinto v Badman (1891) 8 RPC 181
Seramco Ltd Superannuation Fund Trustees v ITC [1977] AC 287
Snook v London and West Riding Investments Ltd [1967] 2 QB 786

J G A Grady for the Commissioner of Inland Revenue.
Philip Poon of P & B Management Services Ltd for the taxpayer.

Decision:

This appeal relates to a claim by the Taxpayer company ('the company') that it should be granted a deduction in respect of the cost of the acquisition of a 'trade mark and design' by virtue of section 16E of the Inland Revenue Ordinance.

The relevant facts were as follows:

1. The company was incorporated in August 1980 and commenced a manufacturing business in October 1980.

2. Prior to the incorporation of the company and it commencing business, a Mr A and Mrs B had carried on a manufacturing business in partnership. This partnership business ceased operations from 27 October 1980 when the plant and machinery owned by the partnership were sold to the company at its then market value, and the company de facto took over the manufacturing business previously run by the partnership.

3. The partnership and the company used different names, but both shared the word 'X' as the first word of their respective names. The partnership had used a stylised letter X as the initial letter of the word 'X' and this stylised letter X was taken over and used by the company.

4. It was common ground between the parties that the company had been incorporated to take over the unincorporated business of the partnership and

had done so with effect from 27 October 1980. The two shareholders who incorporated the company were the two partners of the partnership, namely, Mr and Mrs A.

5. On 14 July 1983, the Inland Revenue Ordinance was amended by the introduction of section 16E which provided that expenditure incurred on the purchase of rights to any trade mark or design would be an allowable expense in computing the profits of a trade or business.

6. By an agreement dated December 1983, the company, as purchaser, purported to acquire from the partnership, as vendor, the trade mark and design comprising the stylised letter X for a consideration of $400,000. The consideration was calculated as being equal to approximately 3.5% of the average turnover of the company during each of the years 1982 and 1983.

7. In its tax computation for the year of assessment 1983/84, the company claimed the sum of $400,000 as an allowable deduction from its assessable profits, thereby creating a tax loss in that year which the company claimed could be carried forward into the subsequent year of assessment 1984/85.

8. The assessor disallowed this claim for the deduction of $400,000, with the result that the company made a profit in the year of assessment 1983/84 and had no carry-forward loss.

9. The company objected to this disallowance but the Commissioner by his determination confirmed the assessment and disallowed the deduction of $400,000.

At the hearing of the appeal the Taxpayer was represented by Mr Philip Poon of P & B Management Services Ltd who submitted that section 16E applies to both registered trade marks and unregistered trade marks. He submitted that the vendor partnership had a valuable property right at the date when the trade mark and design were assigned to the company and that the agreement dated December 1983 was a bona fide transaction and not an artificial transaction which could be disregarded under section 61 of the Inland Revenue Ordinance.

Mr Poon referred us to the case of Cape Brandy Syndicate v IRC [1921] 1 KB 64 in support of his submission that the reference in section 16E was to any trade mark and not just to a registered trade mark.

In support of his submission regarding section 61, Mr Poon referred us to CIR v Howe (1977) 1 HKTC 936 and Snook v London and West Riding Investments Ltd [1967] 2 QB 786.

Mr Grady representing the Commissioner accepted that section 16E referred to registered and unregistered trade marks and designs, but submitted that the stylised letter X did not constitute either a trade mark or design. He further submitted that, if the stylised letter X did constitute a trade mark or design, the partnership did not have any property right which it was capable of assigning in December 1983 because the partnership had long since ceased business and the company had likewise been de facto carrying on business and using the stylised letter X. Finally, he submitted that the agreement dated December 1983 was artificial within the meaning of section 6l of the Inland Revenue Ordinance.

In support of his submission, Mr Grady referred us to the definition of the word 'trade mark' appearing in Stroud's Judicial Dictionary 4 edition at page 2802 and the following cases:

1. Pink v J A Sharwood and Co Ltd (1913) 30 RPC 725

2. Pinto v Badman (1891) 8 RPC 181

3. Seramco Ltd Superannuation Fund Trustees v ITC [1977] AC 287

4. Re American Greetings Corp's Application [1984] 1 All ER 426

5. FCT v Just Jeans Pty Ltd (1987) 87 ATC 4373

6. Erven Warnink BV v J Townend and Sons (Hull) Ltd [1979] AC 731

This case depends entirely upon its facts and it is fortunately not necessary for the Board of Review to consider complex questions of law relating to trade marks and designs. The stylised letter X appears to us to be capable of being considered to be a trade mark. Whether or not the trade mark was registered is immaterial because section 16E of the Inland Revenue Ordinance is not limited to registered trade marks.

As we have held on the facts that the stylised letter X is a trade mark, it is not necessary for us to consider whether or not it also constitutes a design. However it would appear to us that the word design appearing in section 16E relates to a different form of intellectual or industrial property than a trade mark.

As at 27 October 1980, the company could have purchased from the partnership the trade mark owned by the partnership comprising the stylised letter X. However, it did not do so or, if it did, then it was included in the acquisition by the company of the business previously carried on by the partnership. It is clear from the facts of this case that, with effect from 27 October 1980, the company had assumed de facto ownership of the stylised letter X. It would appear that from that date it carried on the business previously carried on by the partnership and there was no objection from the partnership to the company taking over and using the trade mark and the goodwill previously owned and used by the partnership. There is nothing unusual in such an arrangement which often happens when a

partnership is converted into limited company. With effect from 27 October 1980, the partnership ceased carrying on business and gave up in favour of the company any rights which it might have had to the stylised letter X.

We have no doubt that the agreement dated December 1983 came into existence as a direct result of the concession introduced by section 16E earlier that year. We have no doubt that no formal agreement would have been executed if the law had not been amended.

Unfortunately for the company, it had already taken over and been using the trade mark for a substantial period of time. During that period, the partnership had permanently ceased business and had made no claim to the trade mark. As at December 1983, there was nothing left which the partnership could sell to the company. The acid test must be to ask the question whether or not the partnership could as at that date have brought proceedings against the company to restrain the company from using a trade mark owned by the partnership. The answer to such a question must be negative.

For the reasons stated, we find that the company did not acquire rights to the trade mark by virtue of the agreement dated December l983. By that date, the company already owned the rights to the trade mark. Accordingly, the company is not allowed to deduct from its assessable profits the payment of $400,000 made under the agreement.

For the reasons given, we dismiss this appeal and confirm the Commissioner’s determination.