Case No. D51/12

Case stated – whether questions proposed are proper questions of law – section 69(1) of the Inland Revenue Ordinance ('the IRO').

Panel: Horace Y L Wong SC (chairman), Lo Pui Yin and Wong Ho Ming Horace.

Date of hearing: Stated case, no hearing.
Date of decision: 5 March 2013.

By the Decision (D14/12) dated 9 July 2012, this Board allowed in part three items of deductions contended by the Taxpayer for the years of assessment 1996/97 to 2001/02.

On 24 July 2012, the Revenue invited the Taxpayer to comment yet received no response from the Taxpayer on the revised profits tax computation.

By a letter dated 8 August 2012, the Taxpayer requested this Board to state a case to the Court of First Instance.

On 4 September 2012, the Taxpayer submitted six questions of law for the opinion of the Court of First Instance:

1. Due to the long period of delay in delivering its Decision (D14/12), this Board may not find the Taxpayer's witness an unreliable witness;

2. If the Board was not entitled to find the Taxpayer's witness an unreliable witness, had the Board erred in finding that each and every of the six sets of transactions the Taxpayer had had with [Company B] was commercially unrealistic and artificial;

3. This Board did not 'in fact' apply the test in Seramco Trustees v Income Tax Commissioners [1977] AC 287;

4. Section 61 of the IRO is unconstitutional;

5. Had section 61 of the IRO been held unconstitutional, whether the Board had failed to discharge its statutory duty under section 68(8);

6. Whether the Board had wrongly applied the law and erred in ruling that no part of the insurance premium should be allowed as a deductible expense.

Held:

1. The Board has a power to scrutinize the question of law proposed for it to state a case under section 69(1).

2. The Board is duty bound to decline to state a case if the question of law proposed to be stated is not a proper one.

3. None of the six questions proposed by the Taxpayer is a proper question of law.

Application refused.

Cases referred to:

Seramco Trustees v Income Tax Commissioners [1977] AC 287
Commissioner of Inland Revenue v Inland Revenue Board of Review [1982] 2 HKLR 40
Aust-Key Co Ltd v Commissioner of Inland Revenue [2001] 2 HKLRD 275
Honorcan Ltd v Inland Revenue Board of Review [2010] 5 HKLRD 378
Esquire (Electronics) Ltd v HSBC & Anor [2007] 3 HKLRD 439
Expectation Pty Ltd v PRD Realty Pty Ltd & Anor (2004) 140 FCR 17
D24/06, (2006-07) IRBRD, vol 21, 461

Decision:

1. By a Decision dated 9 July 2012 (D14/12) ('the Decision of 9 July 2012'), this Board of Review allowed in part the appeal by the Taxpayer against the determination of the Deputy Commissioner of Inland Revenue dated 24 December 2008 revising the assessable profits for the years of assessment 1996/97, 1997/98, 1998/99, 1999/2000, 2000/01 and 2001/02 and required the Revenue to revise the profits tax assessments of the Taxpayer for those years of assessment according to the Decision, which allowed three items of deductions.[1] The Revenue subsequently submitted on 4 September 2012 the revised computation of the profits tax payable for those years of assessment to the Clerk to the Board of Review for the record.[2]

[1] A corrigendum to the Decision was issued on 10 August 2012.

[2] The Taxpayer was invited by the Revenue on 24 July 2012 to raise any questions it may have on the revised computation. According to the Revenue, there was no response from the Taxpayer on the revised computation.

2. By a letter dated 8 August 2012 and received by the Clerk to the Board of Review on the same date, the Taxpayer requested this Board of Review to state a case to the Court of First Instance to consider questions of law under three headings identified as (A), (B) and (C). The Taxpayer also stated in the letter that it reserved the right 'to submit additional grounds or to amend the aforesaid grounds within 28 days' time'.

3. The Taxpayer then submitted to the Clerk to the Board of Review on 4 September 2012 six questions of law that it considered to be suitable for the opinion of the Court of First Instance. They are listed as follows:

> ' 1. Given that there has been a long period of delay in delivering the Decision, whether the Board was entitled to find, or had erred, and/or had given sufficient reasons, in finding, that [Ms F] was an unreliable witness:
>
> (1) It is well-established that a period of long delay in delivering a decision raises a question as to how much of what transpired at the hearing has been remembered by the fact-finders. In cases of significant delay, it is for the fact-finder to put beyond question any suggestion that he or she has lost an understanding of the issues. Also, the fact-finder is required to give a more comprehensive statement of relevant evidence in order to make manifest to the parties that delay has not affected the decision: Esquire (Electronics) Ltd v HSBC & Anor [2007] 3 HKLRD 439 (CA).
>
> (2) In the present case, there has been a considerable period of delay of more than 3 years for the Board to deliver its Decision.
>
> (3) In finding that [Ms F] was an unreliable witness, the Board gave the reasoning in Paragraph 32 of the Decision [which was quoted in part in the submission].
>
> (4) The Board had not set out comprehensively the "specific matters" which [Ms F] was said to have failed to explain in cross-examination.
>
> (5) Further or alternatively, any reliance of the Board on [Ms F's] demeanour in giving her evidence would be unsafe and unreliable after lapse of more than 3 years.
>
> (6) By reason of foregoing, the Board has failed to make manifest to the Taxpayer that delay has not affected the decision, and hence its finding that [Ms F] was not an unreliable witness, and thereby rejecting her evidence, was erroneous.

2. If the Board was not entitled to find, or had erred in finding, that [Ms F] was an unreliable witness, whether the Board had erred in finding that each and every of the six sets of transactions in the years of assessment in question said to be associated with the management services arrangements the Taxpayer had had with [Company B] was commercially unrealistic and artificial by:

   (1) Erroneously preferring the breakdown of the management fee supplied by [Company H] to [Ms F's] evidence (paragraph 36 of the Decision)

   (2) Erroneously rejecting [Ms F's] evidence, and hence the Taxpayer's case, that part of the management fees paid to [Company B] was attributable to the interest expenses factor relating to the Taxpayer's use of [Company B's] banking facilities (Paragraphs 20 and 37 of the Decision).

   (3) Erroneously rejecting [Ms F's] evidence, and hence the Taxpayer's case, that part of the management fees paid to [Company B] was attributable to the consultancy services provided by [Company B] to the Taxpayer (Paragraph 38 of the Decision).

3. Whether the Board has in fact applied the test in deciding whether the transaction is "artificial" as set out in <u>Seramco Trustees v Income Tax Commissioners</u> [1977] AC 287 at 298A-D and <u>Cheung Wah Keung v CIR</u> [2002] 3 HKLRD 773 at §41 (identified at Paragraphs 29 to 30 of the Decision) in reaching the conclusion that "each and every of the six sets of transactions in the years of assessment in question said to be associated with the management services arrangements the taxpayer had had with [Company B] was artificial" (see Paragraph 41 of the Decision) in that:

   (1) Notwithstanding the Board has rightly identified the test that whether a transaction is commercially unrealistic can be <u>one of the considerations</u> for deciding whether the transaction is "artificial" (see: Paragraph 30 of the Decision), the Board has not considered other factors apart from the consideration of whether the transaction at issue is commercially unrealistic (see: Paragraphs 36 to 40 of the Decision).

   (2) On a proper analysis, all the factors taken into account by the Board in Paragraphs 36 to 40 of the Decision only concern with the

commerciality of the transaction with respect to the management fees.

(3) The Board has erred in not having considered sufficiently or at all any other factors but merely the commerciality of such transaction with respect to the management fees paid to [Company B] and has substituted the test of whether a transaction is "artificial or fictitious" with the consideration of whether the same is commercially unrealistic.

(4) Even if the Board had rightly come to the conclusion that the transaction with respect to the management fees paid to [Company B] is commercially unrealistic, it does not necessarily follow that it is to be regarded as being "artificial" (see: Paragraph 30 of the Decision). In this regard the Board has erred in not having considered sufficiently or at all the entire circumstances of each and every of the six sets of transactions associated with the management services arrangements the Taxpayer had with [Company B] ("the [Company B] Transactions") before concluding that the lack of commercial realism per se is to be regarded as being "artificial".

4. Whether Section 61 of IRO is constitutional in that the Board, upon its finding that the [Company B] Transactions were artificial, had to disregard the said Transactions in their entirety without allowing a reasonable sum representing the Taxpayer's use of services provided by [Company B]:

(1) A taxpayer is entitled to claim deduction of expenses to extent it was incurred with a view to the production of profits: Sections 16 and 17(1)(b) of the IRO.

(2) Section 61 of IRO, however, compel the assessor, or in this case the Board, to adopt the "all-or-nothing" approach by either allowing the transaction to stand or simply disregarding it.

(3) By disregarding the transaction caught by Section 61, the taxpayer is deprived of its entitlement to deduction of expenses which would have otherwise been deductible pursuant to Sections 16 and 17(1)(b) of the IRO.

(4) The deprivation of the statutory entitlement under Section 16 and 17(1)(b) of the IRO is disproportionate, and hence unconstitutional.

5. Had Section 61 of the IRO been held unconstitutional, whether the Board had failed to discharge its statutory duty under Section 68(8) of the IRO in disposing of the Taxpayer's appeal:

   (1) The Board, after hearing the appeal, has a statutory duty to confirm, reduce, increase or annul the assessment appealed against or may remit the case to the CIR with the opinion of the Board thereon: Section 68(8) of the IRO.

   (2) Where the Board finds that the transaction is artificial or fictitious, the Board, in disposing of the appeal, shall be obliged to confirm or reduce the assessments, as the case may be, to neutralize the commercial unrealism or artificiality of the transaction.

   (3) In the present case, the Taxpayer had used various premises owned by [Company B] for its production of profits.

   (4) In addition, subject to the outcome of Question 2, the Taxpayer had used the consultancy and banking facilities provided by [Company B].

   (5) In reaching the conclusion at Paragraph 41 of the Decision, the Board has failed to direct its mind to consider the extent or portion of the management fees paid pursuant to each of the transactions, which is or is not commercially unrealistic or artificial.

   (6) Accordingly, the Board has failed to exercise its discretion to consider whether or not specific portion of the management fees paid in each and every of the six transactions with [Company B] should be upheld instead of striking down the entirety of the management fees paid pursuant to each of such transaction.

6. Whether the Board had wrongly applied the law and erred in ruling that no part of the insurance premium should be allowed as a deductible expenses (See: Paragraph 59 of the Decision):

   (1) The Board did not reject [Ms F's] evidence that [Mr A] used the motor vehicle to travel between offices and between offices and courts.

   (2) However, the Board rejected the Taxpayer's claim on the ground that the insurance premium would have been incurred in any event by [Mr A] in order to use the motor vehicle for private purposes.

(3) Section 16(1) of the IRO expressly allowed the Commissioner, or the Board in the present appeal, to apportion the expenses claimed in deciding the extent to which they are incurred in the production of profits in respect of which the taxpayer is chargeable to tax.

(4) Where the expenditure has a dual purpose, partly for a domestic or private nature, and partly for the purposes of the preservation of the taxpayer of his own person as an asset to his business, the deduction is allowed to the extent that the expenditure is a domestic or private character: Patrick Fahy (t/a AP Fahy & Co) v CIR [1992] 1 HKLR 207.

(5) Hence, in rejecting the claim, the Board had failed to consider the possibility of apportionment, and to allow the Taxpayer's claim to the extent that such expenditure was incurred in the production of profits.'

4. The Revenue was sent the Taxpayer's proposed questions of law dated 4 September 2012 for comments. On 4 October 2012, the Revenue lodged with the Clerk to the Board of Review its comments on the Taxpayer's proposed questions of law, together with the following enclosures: Witness statement of Ms F; Page 6 of the transcript for the hearing dated 25 June 2009; and the Appellant's Closing Submissions dated 30 June 2009. The Revenue submitted that none of the Taxpayer's six proposed questions of law were proper questions of law and they should not be stated and referred to the Court of First Instance for its opinion.

5. The Taxpayer was sent the Revenue's comments on the Taxpayer's proposed questions of law and the documents enclosed therewith. On 14 November 2012, the Taxpayer provided the Clerk to the Board of Review its submissions in reply to the Revenue's comments on the Taxpayer's proposed questions of law. The Taxpayer maintained that the six proposed questions of law were proper questions of law for the purpose of stating a case for the opinion of the Court of First Instance.

6. This Board has considered the written submissions of the Taxpayer and the Revenue.

7. Section 69(1) of the Inland Revenue Ordinance (Chapter 112) provides that the decision of the Board of Review shall be final, subject to the provision that either the appellant or the Commissioner may make an application requiring the Board to state a case on a question of law for the opinion of the Court of First Instance.

8. This Decision thus decides the Taxpayer's application under section 69(1) of the Inland Revenue Ordinance to require this Board to state a case for the opinion of the Court of First Instance on the basis of the six proposed questions.

This Board's approach

9. The Board of Review has a power to scrutinize the question of law proposed for it to state a case under section 69(1) of the Inland Revenue Ordinance to ensure that it is proper for the court to consider: Commissioner of Inland Revenue v Inland Revenue Board of Review [1989] 2 HKLR 40, HC at 57H-J. If the Board is of the view that there is no proper question of law, the proper course for it to take is to decline the request to state a case: Aust-Key Co Ltd v Commissioner of Inland Revenue [2001] 2 HKLRD 275, CFI at 283A-C. These cases and a number of subsequent cases were discussed by Fok J (as he then was) in Honorcan Ltd v Inland Revenue Board of Review [2010] 5 HKLRD 378, where the judge held that the Board was duty bound to decline to state a case if the question of law proposed to be stated is not a proper one, 'as the authorities have consistently held' (at [50]).

Question 1

10. The Taxpayer complains that this Board may not find that Ms F, the Taxpayer's witness, was an unreliable witness for the reasons it gave in its Decision of 9 July 2012 because due to the long period of delay in delivering the Decision, the reasons put forward in the Decision for making that finding were not such as 'to make manifest to the Taxpayer that delay has not affected the decision'. The Taxpayer, having reviewed the comments of the Revenue, accepted that 'mere delay in itself is not a ground of appeal or complaint. Rather, the issue is whether in view of the substantial delay in delivering the decision that is a lapse of 3 years, the Board has in arriving at the finding that [Ms F] was an unreliable witness provided comprehensive statement of relevant evidence in order to make manifest to the Taxpayer that delay did not affect its decision'. Reliance was placed on Esquire (Electronics) Ltd v HSBC & Anor (above).

11. This Board is not satisfied that the Taxpayer's complaint in the preceding paragraph raises a proper question of law. As the Revenue has rightly observed, the Taxpayer's complaint is not directed against any finding of fact (whether primary or by way of inference). In the case of Esquire (Electronics) Ltd v HSBC & Anor (above) relied upon by the Taxpayer, the Court of Appeal did not impose upon a fact-finding tribunal a requirement that in cases where there is significant delay between the taking of evidence and the making of the decision, the tribunal has to 'give a more comprehensive statement of relevant evidence in order to make manifest to the parties that the delay has not affected the decision' or 'put beyond question any suggestion that he or she has lost an understanding of the issues'. The point made in Esquire is that delay in issuing a judgment weakens the usual advantage of the trial judge in having seen and heard the witnesses, so that in cases where the findings of fact that are made by the trial judge depends upon his impression of the witnesses, such findings of fact would be scrutinized with greater care by the appellant court. Whether the findings of fact by the trial judge are affected in the way as aforesaid must depend on the particular circumstances of the case, including, for example, whether the findings sought to be impugned are findings that are made based on the trial judge's impression of the witnesses (as Stock JA (as he then was) said, '*the **caveat** that underscores the importance of the circumstances of the particular case and judgmen*t'). The passages

cited by the Court of Appeal from Expectation Pty Ltd v PRD Realty Pty Ltd & Anor (2004) 140 FCR 17, Fed Ct Aust at 32 were also concerned with how appellate judges hearing a civil appeal should examine the first instance judgment where a significant delay was involved between the taking of evidence and the making of the decision. This Board accepts the observation of Revenue that it remains for 'the appellant … to demonstrate errors in the judgment in the usual way'. The Taxpayer cannot simply make a general complaint about this Board's view of Ms F's credibility without identifying what exactly it says are the errors in the Board's finding of facts. In these circumstances, this Board is unable to accept that Question 1 as formulated by the Taxpayer is a proper question for a case to be stated for the opinion of the Court of First Instance.

12. The Taxpayer also complains under the rubric of Question 1 that this Board had failed in paragraph 32 and subsequent paragraphs of the Decision of 9 July 2012 to set out those 'many of the specific matters' that Ms F was held to have failed to explain when asked in cross-examination. Once the theme of Question 1 has been discussed and determined (see above), it can be readily appreciated that there is nothing of substance in the claimed failure. The Revenue has provided in paragraph 9 of its comments of 4 October 2012 a correct reading of this Board's Decision of 9 July 2012. As rightly observed by the Revenue: 'What the Board was doing in paragraph 32 of the Decision was to make the general observation that [Ms F's] evidence was unreliable. The Board [went] on to identify in subsequent paragraphs the specific matters on which it preferred other evidence, and to explain why, see (for example) the second, third and fourth bullet points on page 14 of the Decision'.

13. This complaint, assuming but without accepting that it can be separately asserted, does not give rise to a proper question of law.

Question 2

14. This Board is satisfied that Question 2 is predicated upon Question 1 being held to be a proper question of law. Since this Board has held above that Question 1 is not a proper question of law for the purpose of stating a case for the opinion of the Court of First Instance from the Decision of 9 July 2012, it also holds that Question 2 is not a proper question of law for the purpose of stating a case for the opinion of the Court of First Instance.

15. This Board also accepts the comment made by the Revenue that Question 2, as it stands alone, cannot be a proper question of law since it seeks to ask the Court of First Instance to re-evaluate the evidence before this Board. This is impermissible.

16. This Board further accepts the comment made by the Revenue that the three particulars of Question 2 were formulated in such a way as to obscure the true reason(s), as set out in the Decision of 9 July 2012, in making the relevant finding with respect to each of the three matters particularized under Question 2. Without pointing to the primary facts found by the Board and identifying the precise ground(s) as to why the Taxpayer says that

those primary facts do not admit of the Board's conclusion (that the transactions with Company B were artificial), the Taxpayer has not made out a proper question of law for case stated: see Commissioner of Inland Revenue v Inland Revenue Board of Review (above).

Question 3

17. The Taxpayer complains through Question 3 that this Board, in coming to its Decision of 9 July 2012, did not 'in fact' applied the test it rightly identified in paragraphs 29 and 30 of the Decision (a matter that the Taxpayer accepts). The Taxpayer submits in reply that notwithstanding all the matters relied on by the Taxpayer (which the Taxpayer accepts, have been exhaustively set out in paragraphs 36 to 40 of the Decision), this Board 'was under the duty to but had nevertheless failed to consider sufficiently or at all, the other factors or the entire circumstances of each and every of the six sets of transactions associated with the management services arrangements the Taxpayer had with Company B before concluding that the lack of commercial realism per se is to be regarded as being "artificial".' The Revenue has pointed out that paragraph 35 of the Decision sets out the Taxpayer's case at the hearing, which was that the management service arrangements with Company B were commercially realistic; that paragraphs 36 to 39 discuss each of the aspects of the Taxpayer's case; and that paragraph 40 discusses other matters that might assist in determining the nature of the transactions, which extend the consideration beyond the question of whether the arrangements for, and the actual payments of, the management fees were commercially unrealistic. The Revenue has also pointed out that the Taxpayer has not identified any matter which this Board allegedly failed to consider. It is important to note that this Board concluded the discussion with respect to the Company B transactions in paragraph 41 of the Decision by holding that not only was the Taxpayer's case (relying on the four factors in support of its setting the range and fixing the actual amount of management fees in a commercially realistic manner) not established, but also that this Board '*further accepts that there are additional features, identified in the preceding paragraph [that is paragraph 40], that point to the artificiality of the transaction in question in the ordinary sense of that expression*'. In these circumstances this Board is not satisfied that Question 3 poses a genuine or proper question of law suitable for a case to be stated, and that in any event what is purportedly put forward is plainly and obviously unarguable.

18. The Revenue has commented that the fourth particular under the rubric of Question 3 can be treated as a complaint that this Board has failed to consider each of the six transactions with Company B 'individually, as separate transactions'. It does not appear that the Taxpayer has adopted this point in reply. In any event it appears to this Board that the Revenue has correctly identified the answer to this point (assuming that the point is taken by the Taxpayer): that paragraph 31 of this Board's Decision of 9 July 2012 has already set out the correct and appropriate approach in the circumstances of the Taxpayer's appeal. Thus this Board is satisfied that this particular cannot, standing alone, be a genuine or proper question of law. It is also plainly and obviously unarguable.

Question 4

19. The Taxpayer complains through Question 4 that section 61 of the Inland Revenue Ordinance is unconstitutional. The complaint fails to specify the particular constitutional instrument applicable to the HKSAR (and the provision thereof) against which section 61 is said to be inconsistent.

20. More importantly, as the Revenue has commented, this complaint could have been but was not before this Board at the hearing. During the hearing, an application was made for leave to rely on additional grounds of appeal but this complaint was not one of the proposed additional grounds associated with that application. The point of constitutionality was never argued before this Board and this Board did not rule on it. It is difficult to see how this Board could be said to have erred on a point that it has never ruled upon.

21. The Taxpayer's reference in reply to the powers of the Board of Review under section 68(8) of the Inland Revenue Ordinance does not assist, since the section 68(8) powers are powers to be exercised by the Board in making its decision after hearing the appeal. As Fok J indicated in <u>Honorcan Ltd v Inland Revenue Board of Review</u> (above) at [36], this Board, having reached its decision on the Taxpayer's appeal, is functus officio in respect of the decision that it has already made.

22. The suggestion that this Board may state a case under section 69(1) for the opinion of the Court of First Instance on a question of law that was only first raised after it has reached its decision simply goes against the statutory scheme of the Board of Review: particularly the provisions in section 66(3) restricting the grounds of appeal; in section 68A for correction of clerical mistakes and accidental slips or omissions in decisions (as opposed to review or re-opening of a decision); and in section 69(1) providing for the finality of the Board's decision.

23. Accordingly, this Board holds that Question 4 is not a proper question of law for the purpose of stating a case for the opinion of the Court of First Instance.

Question 5

24. This Board is satisfied that Question 5 is predicated upon Question 4 being held to be a proper question of law. Since this Board has held above that Question 4 is not a proper question of law for the purpose of stating a case for the opinion of the Court of First Instance, it also holds that Question 5 is not a proper question of law for that purpose.

25. Additionally, it is not open to the Taxpayer, after this Board has already made its decision on the Taxpayer's appeal, to raise the issue of the Board's discretion in apportioning the management fees paid to Company B. The issue was not properly raised as a ground of appeal before this Board at the hearing, whether as an original or additional ground of appeal. For the same reasons given in relation to Question 4 above, the issue is

not one that can properly constitute a proper question of law for a case to be stated for the opinion of the Court of First Instance.

26. The Taxpayer submitted in reply that the Board of Review should have an unfettered discretion to consider the extent or portion of the management fees paid pursuant to each of the transactions with Company B that was or was not commercially unrealistic or artificial. This Board is of the view that this point cannot in any event give rise to a proper question of law for a case stated as no attempt had ever been made by the Taxpayer in its appeal to put forward a 'realistic, rational and feasible' basis for determining the extent or portion of the management fees paid that was or was not commercially unrealistic or artificial; see D24/06, (2006-07) IRBRD, vol 21, 461 at [39]. Thus the question is one that is plainly and obviously unarguable.

Question 6

27. The Taxpayer complains through Question 6 that in relation to the insurance premium for the motor vehicle, this Board has failed to consider the possibility of apportionment and to allow the Taxpayer's claim to the extent that such expenditure was incurred in the production of profits.

28. This Board is satisfied that Question 6 is not a proper question of law for stating a case for the opinion of the Court of First Instance. As the Revenue has rightly noted, the Taxpayer had sought the deduction of the entirety of the insurance premium for the motor vehicle at the hearing. Again there was no attempt to put forward a 'realistic, rational and feasible' basis for apportionment. The question is therefore plainly and obviously unarguable.

Conclusion and disposition

29. By reason of the matters aforesaid, this Board is satisfied that none of the six questions proposed by the Taxpayer for the purpose of stating a case for the opinion of the Court of First Instance is a proper question of law. The Taxpayer's application under section 69(1) of the Inland Revenue Ordinance for this Board to state a case is accordingly refused.