

Case No. D95/04

Profits tax – deduction of loan interest expenses and related expenditure borrowed for the purpose of producing chargeable profits under section 16(1)(a) – whether further conditions in subsection (2) were satisfied – whether the ‘Ramsay principle’ was applicable to section 16 of the Inland Revenue Ordinance (‘IRO’) – whether there was any artificial or fictitious transaction – whether the sole or dominant purpose was the obtaining of a tax benefit - onus of proving assessment excessive or incorrect was on the appellant – sections 16(1)(a) & (2)(d), 17(1)(b), 51(4)(a), 61, 61A & 68(4) of the IRO.

Panel: Colin Cohen (chairman), Mabel Lui Fung Mei Yee and Anthony So Chun Kung.

Dates of hearing: 15, 16, 17, 19, 22, 23, 25 and 26 November 2004.

Date of decision: 16 March 2005.

This was an appeal (heard at the same time as that in D94/04 concerning Company A) by Company B which was a special purpose company (‘SPC’) incorporated in Commonwealth Q on 20 October 1992, with an authorized capital of HK\$1,060,000,002 divided into two ordinary shares of HK\$1 each (both being held by Bank R throughout the relevant period) and 1,060,000,000 cumulative redeemable preference shares of HK\$1 each (all being subscribed by Company G which was also incorporated in the Commonwealth Q and was a wholly-owned subsidiary of Company D). The object of the establishment of the SPC was to enter into a sub-participation agreement with Bank R, thereby completing the circle of funds within the Company AW Group. Being a SPC, Company B was to receive the funding provided by Company AW Group as subscription to its non-voting preference shares and to sub-part in the loan earning interest, which would be distributed to Company AW Group as a non-Hong Kong sourced income. In order to ensure that Bank R would not be subject to any commercial risk of default, it was arranged that Company B, when it received the fund of HK\$1,060 million, which originated from Bank R and had passed through the accounts of Bank C, Company A, Company F and Company G, on 2 November 1992, would place the fund on deposit with the Country W branch of Bank C for one night, and the deposit would be uplifted on 3 November 1992 and transferred back to Company B’s Bank R account and then paid to Bank R under the Sub-Participation Agreement.

Held:

(2005-06) VOLUME 20 INLAND REVENUE BOARD OF REVIEW DECISIONS

Unlike its stance towards the appeal in respect of Company A, the Commissioner indicated through Leading Counsel that they did not intend to oppose the Company B's appeal in B/R 22/04. Accordingly, the Board was invited to make an order allowing the Company B's appeal.

Appeal allowed.

Gladys Li SC, Anderson Chow SC, Jin Pao and Simon Lau instructed by Department of Justice for the Commissioner of Inland Revenue.

John Gardiner QC, Rimsky Yuen SC and Kenny Lin instructed by Messrs Baker & McKenzie for the taxpayer.

Decision:

1. This is an Appeal by Company B. After the conclusion of the Taxpayer's case, Miss Li, SC on behalf of the Commissioner decided not to oppose Company B's appeal.
2. In the light of this, we now allow Company B's appeal and set aside the assessments for the years 1994/95, 1995/96, 1996/97, 1997/98, 1998/99, 1999/2000 and 2000/01.