Shui On Credit Company Limited *(Appellant)*

and

Commissioner of Inland Revenue *(Respondent)*

Court of First Instance
(Inland Revenue Appeal No. 2 of 2007)

Hon Reyes J
Date of Hearing : 25 February 2008
Date of Judgment : 5 March 2008

Court of Appeal
(Civil Appeal No. 85 of 2008)

Hon Rogers VP, Le Pichon JA and Stone J
Date of Hearing : 4 December 2008
Date of Judgment : 18 December 2008

Court of Final Appeal
(Final Appeal No. 1 of 2009 (Civil))

Chief Justice Li, Mr Justice Bokhary PJ, Mr Justice Chan PJ,
Mr Justice Ribeiro PJ and Lord Walker of Gestingthorpe NPJ
Dates of Hearing : 13 and 16 November 2009
Date of Judgment : 30 November 2009

Profits tax assessments – original assessments raised under anti-tax avoidance provision of section 61A – whether open to the Commissioner to rely on sections 16 and 17 to support the assessments – Inland Revenue Ordinance (Cap. 112) section 64(2)

Deduction of expenses – expenditure incurred for acquisition of a right to receive interest payments – capital or revenue nature – Inland Revenue Ordinance (Cap. 112) sections 16(1) and 17(1)(c)

Tax avoidance – profits tax – deduction of deferred expenditure incurred for acquisition of an interest income stream – whether giving rise to a tax benefit – Inland Revenue Ordinance (Cap. 112) section 61A

Shui On Credit Company Limited ("the Taxpayer") was incorporated on 11 March 1988. It was one of the three new companies formed to participate in the scheme described below.

Upon completion of the Shui On Centre ("the Centre property"), a commercial centre in Wanchai, with units let on terms of three to six years, a pre-arranged scheme was effected between several companies in the Shui On group and several outside companies in May 1988. South Castle Limited ("South Castle") assigned the Centre property to Shui On Centre Company Limited ("Centre Co.") at a price of $1.31 billion. Centre Co. obtained a loan facility of $1,200 million ("the Centre Co. Loan") from FPB Finance Limited ("FPB Finance"). Agnew Park Limited ("Agnew") paid $1,200 million to FPB Finance for the latter's rights and obligations under the Centre Co. Loan. Agnew assigned to the Taxpayer for $600 million all of Agnew's right to receive the interest due under the Centre Co. Loan. The Taxpayer obtained a loan facility of $600 million at a floating rate ("the Mitsubishi Loan") from Mitsubishi Bank. Centre Co. paid the loan monies of $1,200 million from FPB Finance to South Castle. South Castle repaid, through Agnew, Hong Kong and Shanghai Banking Corporation $358 million for a loan arranged for the development of the Centre property, settled the inter-company loans of $242 million with Shui On Investment Company Limited, and paid $600 million to Glorion Holding Corporation ("Glorion") for the issue of new Glorion shares to South Castle. Glorion paid $600 million to Bankers Trust Company ("Bankers Trust") and Bankers Trust agreed to discharge FPB Finance's obligation to account to Agnew for the principal repayment of $1,200 million due from Centre Co. to FPB Finance.

As a result of the Swap and Supplemental Swap Agreements ("the Agreements") entered into among BT Asia (HK) Limited, Centre Co. and the Taxpayer, the Taxpayer's interest income from the Centre Co. Loan was cancelled out by its obligation to pay Centre Co. an identical amount of interest. As a result of the Agreements, the Taxpayer also acquired the right to receive payments at floating rate from Centre Co. But this income was equivalent to and therefore cancelled out by the Taxpayer's repayments of principal and interest under the Mitsubishi Loan.

The Taxpayer claimed deduction for the amortisation of the $600 million consideration paid to Agnew for the interest income stream of the Centre Co. Loan together with associated legal and professional fees. The amortisation was referred to as "deferred expenditure" in the Taxpayer's accounts. There were 9 Profits Tax assessments raised on the Taxpayer without allowing the deduction for the deferred expenditure. The assessments were all raised by the Assistant Commissioner invoking section 61A of the Inland Revenue Ordinance ("the IRO").

After considering the Taxpayer's objections, the Commissioner by his Determination upheld the assessments pursuant to sections 16(1) and 61A of the IRO.

The Board of Review dismissed the Taxpayer's contention that issue on sections 16 and 17 of the IRO did not arise because the assessments were raised under section 61A of the IRO. The Board also held that the deferred expenditure was capital in nature and hence not deductible under section 17 of the IRO. Alternatively, the Board concluded that the scheme was entered into for the dominant purpose of enabling the Taxpayer to obtain a tax benefit and that section 61A applied. The Court of First Instance and Court of Appeal upheld the Board's decision and dismissed the Taxpayer's appeal. The Taxpayer appealed to the Court of Final Appeal.

Held by the Court of Final Appeal, dismissing the appeal, that:

(1) An assessment made pursuant to section 61A has the peculiarity that it may be made only by an Assistant Commissioner. But in other respects it is the same as any other assessment.

(2) The Commissioner's administrative role in determination is to consider the matter *de novo*. It was open to the Commissioner to rely on sections 16 and 17 of the IRO, apart from section 61A.

(3) The deferred expenditure was of a capital nature as it was a non-recurring or once and for all payment incurred to obtain an income stream and hence not deductible in accordance with section 17(1)(c) of the IRO.

(4) A tax benefit in the statutory sense is required before section 61A is engaged. In other words, section 61A cannot apply to a tax avoidance scheme which simply does not work.

(5) As it has been held that the deferred expenditure was prohibited from deduction by virtue of section 17(1)(c) of the IRO, the issue whether the Taxpayer was liable under section 61A does not arise for decision.

In the Court of First Instance and Court of Appeal

Mr Barrie Barlow SC (instructed by Messrs Mallesons Stephen Jaques) for the appellant

Mr Ambrose Ho SC and Mr Paul H.M. Leung (instructed by the Department of Justice) for the respondent

In the Court of Final Appeal

Mr David Bloom QC, Mr Barrie Barlow SC and Mr Stewart Wong (instructed by Messrs Mallesons Stephen Jaques) for the appellant

Mr Michael Furness QC, Mr Ambrose Ho SC and Mr Paul H.M. Leung (instructed by the Department of Justice) for the respondent

Cases referred to in the judgment of the Court of Final Appeal:

Ngai Lik Electronics Co. Ltd. v. CIR, FACV No. 29 of 2008

CIR v. Common Empire Limited [2006] 1 HKLRD 942

CIR v. Common Empire Limited [2007] 1 HKLRD 679

CIR v. Tai Hing Cotton Mill (Development) Limited (2007) 10 HKCFAR 704

Mok Tsze Fung v. CIR [1962] HKLR 258

CIR v. The Hong Kong Bottlers Ltd [1970] HKLR 581

CIR v. Board of Review ex parte Herald International Limited [1964] HKLR 224

Wharf Properties Ltd v. CIR [1997] AC 505

Commissioner of Taxes v. Nchanga Consolidated Copper Mines [1964] AC 948

oltness Iron Company v. Black (1881) 6 App Cas 315

IRC v. Church Commissioners for England [1977] AC 329

CIR v. Secan Limited (2000) 3 HKCFAR 411

FCT v. The Myer Emporium Limited (1987) 163 CLR 199

Beauchamp v. FW Woolworth Plc [1990] 1 AC 478

Inland Revenue Commissioners v. John Lewis Properties Plc [2003] Ch 513

CIR v. HIT Finance Limited (2007) 10 HKCFAR 717

Commissioner of Taxation v. Spotless Services Limited (1996) 186 CLR 404

Commissioner of Taxation v. Hart (2004) 217 CLR 216