

**Canton Industries Limited**

*Appellant*

**and**

**Commissioner of Inland Revenue**

*Respondent*

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**Court of First Instance**

**(Inland Revenue Appeal No. 6 of 2007)**

**Hon Reyes J**

**Date of Hearing: 7 March 2008**

**Date of Judgment: 7 March 2008**

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*Profits tax – deductions – expenditures on permanent textile quota – whether of a capital or revenue nature - Inland Revenue Ordinance (Cap. 112) section 17(1)(c)*

The Taxpayer was in the textile business. During the financial years 2000/01 to 2004/05, it was not possible to export textiles to Europe or the USA without quota. It was anticipated that the quota system would come to an end on 31 December 2004. Therefore, the permanent textile quota acquired by the Taxpayer over the relevant years had a short life span. The Taxpayer's accounting policy was to write off permanent quota as being utilised on a straight-line basis over the economic useful lives of the same. The Taxpayer claimed tax deduction in respect of the utilisation of permanent quota.

The Commissioner disallowed the deduction on the ground that it was capital in nature, hence non-deductible under section 17(1)(c) of the Inland Revenue Ordinance. The Board of Review agreed with the Commissioner and dismissed the Taxpayer's appeal. The Taxpayer appealed to the Court of First Instance.

**Held, dismissing the appeal, that:**

- (1) To decide whether an expense is of a capital or revenue nature, one first considers the salient features of an expense. Then, applying commonsense, one assesses whether the sum total of features tip the balance towards one or other nature. There can be grey areas where the correct characterization will have to depend on degree and comparison.

- (2) A number of tests are often resorted to as general guides. They are not necessarily conclusive.
- (3) With the acquisition of permanent quota, the Taxpayer obtained an enduring benefit. That benefit was the ability to conduct business continuously over the duration of the quota. Although the life of the quota may not have been long, such shortness cannot be decisive.
- (4) The acquisition of permanent quota is a once and for all expenditure. Having acquired the permanent quota, provided that it maintains exports at a certain level, a permanent-quota holder can exploit the bundle of exclusive rights which comes with the quota to generate profits for its trade over the life of the quota. Thus, once acquired, the permanent quota became incorporated into the Taxpayer's profit-making structure or fixed capital.
- (5) Expenditure on permanent quota does not have a circulating or recurrent nature. Nor does expenditure on permanent quota have the character of a regular outlay incurred as part of the process of bringing regular returns through the trading of garments.

Mr Neil Thomson, instructed by Messrs Sam Fu & Co, for the Appellant

Ms Yvonne Cheng, instructed by the Department of Justice, for the Respondent

**Cases referred to in the judgment:**

BP Australia Ltd v Commissioner of Taxation [1966] AC 224 (PC)

British Insulated and Helsby Cables Ltd v Atherton [1926] AC 205 (HL)

Vallambrosa Rubber Company Limited v Farmer (1910) 5 TC 529 (Court of Session)

Ammonia Soda Company v Chamberlain [1918] 1 Ch D 286

Sun Newspapers Ltd and Associated Newspaper Ltd v Federal Commissioner of Taxation (1938) 61 CLR 337 (HCA)