

Commissioner of Inland Revenue

*Appellant
(Respondent)*

and

Tai Hing Cotton Mill (Development) Limited

*Respondent
(Appellant)*

**Court of First Instance
(Inland Revenue Appeal No. 8 of 2004)**

Deputy High Court Judge Poon

Dates of Hearing: 9, 10 and 13 June 2005

Date of Judgment: 9 September 2005

**Court of Appeal
(Civil Appeal No. 343 of 2005)**

Hon Rogers, Tang VPP and Le Pichon JA

Dates of Hearing: 7-9 November 2006

Date of Judgment: 22 December 2006

**Court of Final Appeal
(Final Appeal No. 2 of 2007, Civil)**

Mr Justice Bokhary PJ, Mr Justice Chan PJ, Mr Justice Ribeiro PJ, Mr Justice Litton NPJ and Lord Hoffmann NPJ

Dates of Hearing: 12 and 13 November 2007

Date of Judgment: 4 December 2007

Tax avoidance – property development – whether the purchase of land from parent company on certain specific terms gave rise to a tax benefit – whether sole or dominant purpose was to obtain a tax benefit - Inland Revenue Ordinance (Cap. 112) section 61A

The Taxpayer belonged to a group of companies. Its parent company

manufactured cotton spun yarn in Tuen Mun. In 1987, the parent company decided to develop some of its surplus land jointly with a property developer so that it could finance the construction of a new factory and make some additional profit. To implement the plan, the parent company sold the land to the Taxpayer at a price that consisted of an initial sum of some \$346 million, a further sum of \$400 million subject to the Taxpayer realising net profits to meet such a payment and 50% of any additional profits of the Taxpayer. Since the land was the parent company's capital asset, the price it received from selling the land was not subject to profits tax. At the same time, the Taxpayer acquired the land for the purpose of trade and its cost was deductible in calculating its taxable profits. The market value of the land at the time of sale was \$800 million. The Taxpayer paid a total consideration of \$1,084 million to its parent company and claimed deduction of this sum from its taxable profits.

The Commissioner considered that the payment of the excess of the land cost over the market value of the land was not incurred for the purpose of producing the Taxpayer's chargeable profits. She also considered that the purchase and sale of the land between the Taxpayer and its parent company on the terms therein was a transaction entered into for the sole or dominant purpose of obtaining a tax benefit. She disallowed the deduction of the excess land cost pursuant to sections 16, 61 and 61A of the Inland Revenue Ordinance.

On appeal, the Board of Review found that the sale price was not excessive and was realistic from a business or commercial point of view. It also held that the transaction did not confer a tax benefit on the taxpayer and that the transaction was not entered into for the sole or dominant purpose of obtaining a tax benefit. The Board allowed the Taxpayer's appeal.

In allowing the Commissioner's appeal, the Court of First Instance ruled in favour of the Commissioner on both sections 16 and 61A. The Court of Appeal however reversed the Court of First Instance's decision and restored that of the Board of Review. The Commissioner appealed to the Court of Final Appeal on the point of section 61A.

Held, allowing the appeal, that:

- (1) Section 61A applies to a transaction which has the effect of conferring a tax benefit on someone, if it would be concluded, having regard to various matters, that it was entered into for the sole or dominant purpose of enabling that person to obtain a tax benefit.

- (2) The word “benefit” invites a comparison. The comparison is not between the taxpayer’s respective positions with and without the transaction, but between positions on the hypothesis that there was a transaction which created income, with and without the features that conferred the tax benefit.
- (3) If the effect of the transaction is that your liability to tax is less than it would have been on some other appropriate hypothesis, you have had a tax benefit. The tax benefit does not have to relate some other pre-existing source of income, external to the transaction.
- (4) The question in section 61A is not what the purpose of the parties actually was, but the objective question of what would be concluded from a conclusion of the seven matters listed in that section.
- (5) The Commissioner may under section 61A(2)(b) make an assessment on the hypothesis which the evidence suggests was most likely to have been the transaction if the taxpayer had not been able to secure the tax benefit.
- (6) The effect of the transaction in question was capable of conferring a tax benefit on the taxpayer because the ability to deduct all or part of its receipts from the joint venture enabled it to pay less tax than if the price of the land had been its market value.
- (7) The purpose of the transaction was to mop up as large a portion of the taxpayer’s profits as seemed decent in the circumstances and transfer them tax free to the parent company. The parties’ sole or predominant purpose in adopting that method of fixing the price was to obtain a tax benefit.

In the Court of First Instance

Mr Ambrose Ho, SC and Mr Eugene Fung, instructed by the Department of Justice, for the Commissioner

Mr Clifford Smith, SC and Mr Neil Thomson, instructed by Messrs Johnson, Stokes & Master, for the taxpayer

In the Court of Appeal

Mr David Goldberg QC & Mr Eugene Fung, instructed by the Department of Justice, for the Commissioner

Mr Michael Flesch QC, Mr Clifford Smith SC and Mr Neil Thomson, instructed by Messrs Johnson, Stokes & Master, for the taxpayer

In the Court of Final Appeal

Mr David Goldberg QC & Mr Eugene Fung, instructed by the Department of Justice, for the Commissioner

Mr Michael Flesch QC and Mr Clifford Smith, SC, instructed by Messrs Johnson, Stokes & Master, for the taxpayer

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

Europa Oil (NZ) Ltd v Inland Revenue Commissioner [1976] 1 WLR 464

Commissioner of Inland Revenue v Yick Fung Estates Ltd [1999] 1 HKLRD 613

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