Net Widens

An expansive interpretation of the general anti-avoidance provision has led to a taxpayer appealing to the Court of First Instance

In a recent decision of the Inland Revenue Board of Review, *D44/97* 12 IRBRD 292; (1998) HKRC §80-526, involving the application of s 61A – the general anti-avoidance provision in the *Inland Revenue Ordinance* (IRO) – the Board took an expansive view of the provision by applying it to a company's unilateral change of accounting dates.

The taxpayer was a property development company, which changed its accounting year. Under (arcane) IRO rules, set out in s 18E, this caused the main portion of the taxpayer's profits to 'drop out' of the profits tax net. (This rule only applies to taxpayers that commenced business before 1 April 1974.)

The taxpayer's affairs were seemingly arranged so that the property development profits were derived during the 'drop out' period. The Commissioner took the view that the taxpayer's change of accounting date was contrived to take advantage of s 18E in a way which was not intended by the legislature and which was done simply to avoid tax on those profits.

The Commissioner assessed the taxpayer under s 61A (1), specifically taking the view that the taxpayer had entered into a transaction with the sole or dominant purpose of avoiding liability for tax.

The taxpayer initially argued that there was simply no 'transaction' (as required by s 61A) to which the provisions of s 61A could be applied. It contended that the concept of a transaction required dealing between two parties and that a mere unilateral change of accounting date was not a transaction. The Board rejected this argument, holding that unilateral actions fall within the meaning of transaction for the purposes of s 61A.

The taxpayer's second argument was that, having regard to the seven factors set out in s 61A(1) (to which regard must be had to determine whether the taxpayer had entered into the transaction for the sole or dominant purpose of obtaining a tax benefit), it could not be concluded that the taxpayer changed its accounting date for that purpose. The Board held that it was not limited to considering those seven factors and that in appropriate cases it could have regard to the taxpayer's subjective intention. The Board held that:

> Application of the objective test entails critical examination of statements of subjective intention. If those statements are merely self-serving statements and do not accord with the objective facts, application of the objective test does not exclude consideration of such statements. The statements must of course be relevant to one or other of the seven matters specified in s 61A.

Here the Board appears to be stating that, although it could not have regard to the taxpayer's general subjective intention to avoid tax, it could still consider the taxpayer's subjective intention in order to clarify the application of the seven factors set out in s 61A(1).

The Board also held that applying the seven factors is not a 'goal scoring exercise' by which a point is assigned to each of the criterion listed in s 61A(1). The Board said: 'Having regard to each of the seven specified matters, an overall view must be taken whether the person carried out the transaction for the sole or dominant purpose of obtaining the tax benefit.' Thus, in applying s 61A, a general impression of the taxpayer's purpose must be formed by applying the seven factors. Individual factors do not necessarily carry the same weight in every case.

The Board then proceeded to analyse how the seven factors applied to this case. It concluded that the taxpayer's intention was to avoid tax.

The taxpayer's third argument was that the general anti-avoidance provisions could not override a specific provision of the IRO, which provided for the method of assessment where a taxpayer changes its accounting date. The Board also rejected this argument, having regard to the Privy Council's decision in *CIR v Challenge Corporation Ltd* [1987] AC 155, holding that:

> What the Taxpayer did was to engage in a contrived scheme for the sole purpose of avoiding tax. That scheme has no basis in the ordinary business of the Taxpayer. Its reliance on s 18E is tax avoidance and not tax mitigation. On the basis of Challenge, s 61A is available to strike down such contrived scheme.

The taxpayer's fourth argument related to the basis on which the IRD was permitted to make an assessment that extended for a period of more than 12 months. The Board agreed that s 18E did not permit an assessment for a period beyond 12 months. However, it held that s 61A expressly authorised assessment of the taxpayer 'in such ... manner as the Assistant Commissioner considers appropriate to counteract the tax benefit which would otherwise be obtained'. On this ground, the Board rejected the taxpayer's argument.

This decision is important because it affirms the Board's willingness to apply the general anti-avoidance provision and to reject technical arguments that would seek to limit it. The Board's comments about the application of s 61A to unilateral transactions, the relevance of the taxpayer's subjective intention and the relationship between s 61A and other relief provided by the IRO had not been considered previously by the courts in Hong Kong.

The taxpayer has appealed the Board's decision to the Court of First Instance.

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