

19/84

IN THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL

O N A P P E A L

FROM THE COURT OF APPEAL OF HONG KONG

B E T W E E N :

THE COMMISSIONER OF INLAND REVENUE Appellant

- and -

LO AND LO (a firm) Respondent

CASE FOR THE RESPONDENT

Record

10 THE NATURE OF THE APPEAL

1. This is an appeal brought by leave from the judgment of the Court of Appeal of Hong Kong (Leonard V-P, Cons and Zimmern JJ.A) dated 28th September 1982, dismissing with costs the appeal of the Appellant from the Judgment of Mr. Justice Hunter in the High Court of Hong Kong dated 18th March 1982 allowing the appeal by the Respondent by way of Case Stated dated 23rd November 1981 against the decision of the Board of Review disallowing a deduction claimed by the Respondent in computing its assessable profits for profits tax for the year of assessment 1977-78. The judgments in the High Court and the Court of Appeal are reported at [1982] H.K.L.R. 179 and 503 respectively.

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2. The question for decision involves the construction and application of section 16(1) of the Inland Revenue Ordinance of Hong Kong, Cap. 112, and relates to the deductions to be made in ascertaining the chargeable profits of the Respondent firm for the year ending 31st December 1977 being the basis period for the year of assessment 1977-78.

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THE STATUTORY PROVISIONS

3. The relevant provisions of the Ordinance as in force for the year of assessment 1977-78 are set out in the Revised Edition 1981 and are as follows:

"2.(1) In this Ordinance, unless the context otherwise requires -

...

'assessable profits'

means the profits in respect of which a person is chargeable to tax for the basis period for any year of assessment, calculated in accordance with the provisions of Part IV; (Replaced, 28 of 1964, s.2)....

PART IV

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PROFITS TAX

"14. Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in the Colony in respect of his assessable profits arising in or derived from the Colony for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part: (Replaced, 2 of 1971, s.9)...

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"15. (1) For the purposes of this Ordinance, the sums described in the following paragraphs shall be deemed to be receipts arising in or derived from the Colony from a trade, profession or business carried on in the Colony -

(a) " /Here follow several paragraphs specifying particular kinds of sums received or accrued that would not or might not ordinarily be regarded as receipts so arising or derived/

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"(2) Where, in ascertaining for the purposes of this Part the profits of a trade, profession or business carried on in the Colony, a deduction has been allowed for any debt incurred for the purposes of the trade, profession or business, then, if the whole or any part of that debt is thereafter released, the amount released shall be deemed to be a receipt of the trade, profession or business arising in or derived from the Colony at the time when the release was effected.

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"15C. Where a person ceases to carry on a trade or business in the Colony the trading stock of the trade or business at the date of

cessation shall be valued for the purpose of computing the profits in respect of which that person is chargeable to tax under this Part as follows -
(Amended, 28 of 1964, s.6, and 26 of 1969, s.12)

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(a) " Here follow two paragraphs specifying, according to the circumstances, what the value of trading stock shall be taken to be.

"15D. (1) " Here follows a provision regarding post-cessation receipts.

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"(2) Where a person who has ceased to carry on a trade, profession or business in the Colony pays any sum which, if it had been paid before such cessation, would have been deductible in computing the profits of the trade, profession or business in respect of which the person is chargeable to tax under this Part, then to the extent to which the sum has not already been deducted in computing such profits, that sum shall be deducted in ascertaining his profits for the year of assessment in which the cessation occurred. (Added, 26 of 1969, s.13)

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"16.(1) In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period, including

(a) " Here follow paragraphs specifying three particular kinds of sums payable or paid.

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"(d) bad debts incurred in any trade, business or profession, proved to the satisfaction of the assessor to have become bad during the basis period for the year of assessment, and doubtful debts to the extent that they are respectively estimated to the satisfaction of the assessor to have become bad during the said basis period notwithstanding that such bad or doubtful debts were due and payable prior to the commencement of the said basis period:

Provided that-

(i) deductions under this paragraph shall be limited to debts which were included as a trading receipt in ascertaining the profits....

(e) " [Here follow five more paragraphs specifying payments made or expenditure incurred or other allowable deductions, obviously not forming, even with the preceding paragraphs, an exhaustive list of outgoings and expenses to be deducted/. 10

"17.(1) For the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of - (Amended, 36 of 1955, s.25, and 49 of 1956, s.13)...

(b) any disbursements or expenses not being money expended for the purpose of producing such profits; (Amended, 36 of 1955, s.25)... 20

"18 B.(1) Subject to sub-section (2) and to sections 18C, 18D and 18E, the assessable profits for any year of assessment commencing on or after 1 April 1975 from any trade, profession or business carried on in the Colony shall be computed on the full amount of the profits therefrom arising in or derived from the Colony during the year of assessment.

(2) Subject to sections 18C, 18D and 18E, where the Commissioner is satisfied that the accounts of a trade, profession or business carried on in the Colony are made up to some day other than 31 March, he may direct that the assessable profits from that source for any year of assessment be computed on the full amount of profits therefrom arising in or derived from the Colony during the year ending on that day in the year of assessment. (Added, 7 of 1975, s.12)... 30

"22.(1) Where a trade, profession or business is carried on by 2 or more persons jointly the assessable profits therefrom shall be computed in one sum and the tax in respect thereof shall be charged in the partnership name. (Replaced, 36 of 1955, s.31)...." 40

THE ISSUE ARISING

4. The question raised by this appeal is whether

a provision in the accounts of the Respondent firm for 1977 representing a liability for payment of future staff retirement or leaving benefits was an outgoing or expense incurred during 1977 for the purposes of section 16(1) or was otherwise properly deductible in ascertaining the amount of the "profits" for 1977 on which the Respondent is assessable to profits tax under sections 14 and 18B of the Inland Revenue Ordinance, Cap.112.

Record

10 THE FACTS

5. (1) The facts of the case are set out in paragraphs 3 and 17 of the Stated Case and so far as material are summarised in the following subparagraphs.

pp.2-4 and
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(2) The Respondent firm practices in Hong Kong as solicitors.

p.2, 1.6-7

(3) On 3rd January 1977, in order to retain employees, the Respondent introduced a new standard term into the conditions of employment of all its staff. The conditions were set out in a circular letter, clause 5 of which read:

p.2, 1.8-26
p.3, 1.46-
p.4, 1.25

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"5. Any member of the staff who leaves the firm's employment after not less than 10 years service will be entitled to a lump sum payment calculated by multiplying the number of years (complete) employed by the firm by half of his average monthly salary for the last 12 months of his employment. Naturally, this will not apply where a member of the staff is dismissed for dishonesty, serious misconduct or gross inefficiency."

p.3 1.14-26

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(4) The partners of the Respondent firm considered themselves to be legally bound by clause 5 of the circular letter as from 3rd January 1977; previously the Respondent had made similar payments on a voluntary basis.

p.4, 1.19-21

p.2, 1.27-30
p.4, 1.22-25

(5) During 1977 the Respondent made payments totalling \$93,102 to employees in accordance with clause 5.

p.2, 1.33-36

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(6) In its accounts for 1977 the Respondent made a provision of \$770,000 for staff retirement benefits under clause 5. The sum provided was in respect of about 23 employees remaining in employment; the sum was not discounted nor calculated by an actuary nor did it take account of future salary increases.

p.3, 1.20-32

p.10, 1.10-19
and 24-25

(7) In its profits tax computation for 1977-78 based on the accounts for the year ended 31st

p.2, 1.31-33
and 41-48

Record

December 1977 the Respondent claimed, in respect of retirement benefits, a total deduction of \$863,102, being the aggregate of the payments and provision respectively mentioned at (5) and (6) above.

p.3,1.37-40

(8) In raising the assessment to profits tax for 1977-78 the Assessor disallowed that part of the deduction in respect of retirement benefits which represented the provision described at (6) above.

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p.3, 1.41-45

(9) The Respondent objected to the assessment on the grounds that the provision of \$770,000 was an expense incurred in the year 1977 in the production of assessable profits.

THE COURSE OF THE PROCEEDINGS

p.1,1.20-26

6. The Respondent appealed to the Board of Review against the assessment. After oral hearings on 10th and 11th June 1981, the Board of Review confirmed the assessment on 20th July 1981. The Board of Review assumed that clause 5 of the circular letter was enforceable; it decided, however, on the basis of the Australian case of Nilsen Development Laboratories Pty. Ltd v. F.C.T. (1981) 11 A.T.R.505 (High Court of Australia Full Court), that the expense was not incurred in the basis period because the payments did not become due in that year. The Board of Review was of the opinion that the facts closely resembled those in Inland Revenue Commissioners v. Titaghur Jute Factory Co. Ltd. [1978] S.T.C. 166, a decision of the Court of Session, and that the appeal could succeed under English law. The Board of Review accepted the contention of the Respondent that the amount of the provision was sufficiently accurate.

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p.9,1.11-14
p.10,1.10-27

p.10-11

7. The Respondent required the Board of Review to state a case on questions of law for the High Court under section 69 of the Ordinance. The questions posed were in summary:

(i) Whether on the facts it could be held that the provision claimed did not come within the deductions permitted under section 16(1);

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(ii) Whether it was open to the Board of Review to hold that the Respondent had not by the circular letter incurred the liability to make payments in the future;

(iii) Whether Titaghur Jute should have been followed;

(iv) Whether the Board of Review erred in rejecting

the submission of the Respondent firm that a provision for a known liability to make a future payment is deductible if it is a commitment resulting from events in the basis period, and is attributable to that period although not yet finally ascertained.

Record

10 8. (1) Mr. Justice Hunter allowed the appeal on 18th March 1982, answering the first question in the negative and stating, in answer to the third question, that the Board of Review erred in failing to apply the reasoning in Titaghur Jute and Southern Railway of Peru Ltd. v. Owen [1957] A.C.334, 36 T.C. 602, a decision of the House of Lords on a similar question in relation to United Kingdom income tax. On the fourth question, the learned Judge preferred to express the error in the same way than to endorse the precise proposition in this question. p.40

(2) The learned Judge summarised the effect of clause 5 of the circular letter as follows:-

20 "(i) In every year every member of the staff becomes entitled to receive by way of total remuneration a salary divisible into two elements. p.23,1.42- p.24,1.7

(ii) The first element is immediate, and is cash payable at ... e.g. the rate of \$2X a month.

30 (iii) The second element is the entitlement to receive an additional half-month's salary, an additional \$ X for the same year's service. The right to claim the money is contingent upon completion of ten years' service and on not being dismissed" / sc. for dishonesty, serious misconduct or gross inefficiency. "The right to receive it is contingent upon retirement."

40 (3) Although the contingency of completing ten years' service was already satisfied by those members of the staff who had already served ten years and no part of the provision claimed as deductible catered for any other members of the staff, the learned Judge saw, for the purposes of the appeal, no difference in principle between the position of staff with under ten years' service and the position of those with ten years or more. p.24,1.8-23

(4) The learned Judge observed that it was not disputed that, judged by ordinary accounting and commercial standards, the profits of the Respondent should be reduced by the provision. The p.24,1.37-43

Record

question was, however, whether the provision was allowed as a deduction in view of section 16(1), which began with the words "In ascertaining the profits ... there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period...."

p.26,1.14-32 (5) In the absence of direct Hong Kong authority on the point, the learned Judge considered the United Kingdom and Australian cases as an aid to the construction of section 16(1). In the United Kingdom system, where the corresponding enactment, albeit in negative and double negative terms, was section 130 of the Income and Corporation Taxes Act 1970, which reads, "in computing the amount of the profits no sum shall be deducted in respect of... any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession or vocation". In assessing profits for United Kingdom income tax, it had been held in Southern Railway of Peru and Titaghur Jute that a provision such as that claimed was deductible, provided that the figure to be attributed to the future payment could be satisfactorily determined or fairly estimated. On the other hand, under the Australian system, where the corresponding enactment was section 51(1) of the Income Tax Assessment Act 1936-1973 ("All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income or are necessarily incurred in carrying on a business for the purposes of gaining or producing such income shall be allowable deductions..."), it had been held, in particular in Nilsen Development Laboratories v. Federal Commissioner of Taxation, (1981) 11 A.T.R.505 that, in determining taxable income for Australian tax purposes nothing could be deducted in respect of the liability to make a future payment until the year in which the liability became due and payable.

(6) Comparing the United Kingdom and Australian systems, the learned Judge said -

"(i) On the ascertainment of receipts there may be little material difference. Both systems admit the propriety of commercial principles, e.g. [as] to the apportionment or appropriation of income...
(ii) The real differences arise in relation to the computation of deductions. In the United Kingdom this is basically a question of fact to be decided on commercial principles In Australia it is a matter of law and jurisprudence, the question being whether in law the sum became due

and payable during the material year."

Record

10 The learned Judge attributed these differences to a difference in the assessment process. In Australia this consisted of two separate and distinct stages: one an ascertainment of gross income and the other an ascertainment of deductions. It was therefore proper and permissible to treat each separately and to apply different principles to each. But in the United Kingdom the search was for the balance constituting the net profits, and the same principles had necessarily to be applied to both sides of the account, so that if accounting principles were applied to revenue they must equally be applied to deduction.

p.35,1.35-39

p.35,1.39-
p.36,1.4

(7) The conclusion of the learned Judge was that the Hong Kong system was in substance more analogous to the U.K. system. He said,

p.36,1.4-8

20 "It is quite clear from sections 14, 16 and 17 that what the Ordinance raises is a tax on profits and that the steps enumerated in section 16 are steps towards the ascertainment of profit."

p.36,1.8-12

The reasoning in Southern Railway of Peru v. Owen therefore applied precisely. The Hong Kong Ordinance was U.K. in origin and concept and fell to be construed in the light of U.K. principles. Section 15(1) was in material respects paraphrasing and not intending to change the meaning of the corresponding U.K. enactment.

p.36,1.16-19

p.36,1.44-48

p.36,1.40-42

30 (8) The learned Judge considered that it was more convenient and conducive to fairness and justice for a calculation of true profit to govern liability to taxation as well as commercial results.

p.37,1.31-36

(9) On a subsidiary point, the Commissioner of Inland Revenue sought to challenge the finding of the Board of Review in paragraph 18 of the Case. On this contention, the learned Judge said

p.38,1.20-23

40 "I do not see how this is open to him. Whether the firm's estimate was sufficiently precise was a question of fact for the Board. They considered it and answered it in [the Respondent's] favour..... It cannot be said, and indeed is not said, that there was no evidence before the Board upon which it could have reached this result."

p.38,1.24-34

9. By a Notice of Appeal dated 23rd April 1982 the Commissioner appealed from the judgment of the learned Judge. The grounds were that the provision

p.41-42

Record

- p.41,1.22-30 was not an outgoing or expense incurred "during the year of assessment" (sic) for the purposes of section 16(1) because (a) it was a future liability and (b) it was contingent; alternatively, it was contended that the provision was a rough estimate of liability not properly quantified. On 16th June 1982 the Respondent served a Respondent's Notice contending that the principles and practice enunciated in Southern Railway of Peru should be followed and that, even if Australian authorities were relevant, Nilsen was not a satisfactory authority for Hong Kong. 10
- p.42,1.5-11
- p.43
- p.43-58 10. (1) The appeal was heard by the Honourable Mr. Justice Leonard, Vice-President, the Honourable Mr. Justice Cons and the Honourable Mr. Justice Zimmern, Justices of Appeal. On the 28th September 1982 the court unanimously dismissed the appeal.
- p.59
- p.45,1.11-13 (2) In his judgment, with which Zimmern J.A. agreed, the learned Vice-President started by outlining the facts and then summarised the statutory provisions in Hong Kong. He said that the words calling for interpretation were "all outgoing and expenses to the extent to which they are incurred" and pointed out that the legislation appeared to distinguish between "outgoings" and "expenses". 20
- p.49,1.11-14
- p.50,1.32-35
- p.51,1.10-16 (3) The learned Vice-President said that because of the differences between the Hong Kong legislation and the English and Australian legislation, the only case which he found to be of assistance was Commissioner of Inland Revenue v. Mutual Investment Co. Ltd. [1967] A.C. 587, a decision of your Lordship's Board on an appeal from Hong Kong. In the light of that case section 16 might be paraphrased to read: 30
- p.53,1.44-48 "In order to ascertain the taxable profits you shall deduct from the total of receipts and sums deemed to be receipts all outgoing and expenses to the extent to which they are incurred for the production of such profits".
- p.54,1.19-42 He believed that the paraphrase accorded with the passage at pages 598-9 of Mutual Investment, when that passage was read in its context. 40
- p.54,1.1-3 The learned Vice-President said that the issue, whether the lump sums were properly deductible, could be decided by deciding whether the total of the lump sums could be said to be an expense incurred. He said
- p.54,1.3-18 "I think it must be in the ordinary meaning of those words for it is an allowance for the

10 cost of administering a retirement scheme started to avoid losing experienced staff and as such is an expense. This is particularly so if there is to be a difference between 'expense' and 'outgoing'. It is 'incurred' in that liability for it was assumed. I do not, however, think that it is entirely proper to split up the words used in this manner and merely do so as a check on my interpretation of the words 'expenses to the extent to which they are incurred in the production of profits' which to my mind embrace such an allowance as this. I cannot see that [the fact that] the liability was contingent affects the expense resulting from the contingent liability being 'incurred'."

20 (4) On the contention that the Respondent had failed properly to quantify the liability for which it had made provision the learned Vice-President considered that there was implicit in the acceptance by the Board of Review of the contentions of the Respondent a finding that the sum sought to be deducted was accurate. He agreed with Hunter J. that this was not open to review. p.42,1.5-11 p.55,1.34-40

(5) Cons J.A. concurred with the comments of the learned Vice-President on the argument that the Respondent had failed sufficiently to quantify his claim. p.58,1.31-34

30 (6) On the principal point Cons J. agreed in substance with Hunter J. The learned Justice of Appeal pointed out that in neither Australia nor the U.K. were "expenses" limited to sums actually paid in the period. The only material aspect of the facts in Southern Railway of Peru which differed from the present case was covered by the decision in Titaghur Jute; these decisions should in his view be followed unless there was an effective difference in the language of the Hong Kong statute or it operated on a different pattern. As to the language, the U.K. statute was if anything narrower. The pattern of the Hong Kong statute was similar to that in the U.K. in that deductability followed accountancy principles subject to overriding legislation. The use of the word "including" in section 16(1) implied that there were other deductible items not specifically mentioned: these must be determined by accountancy practice. He considered that this conclusion was not inconsistent with the words of Sir Garfield Barwick in Mutual Investment at page 598-9, since there the question was not whether the expenses had been incurred but whether they could be set against particular receipts. p.58,1.14-16 p.56,1.5-19 p.56,1.29-34 p.56,1.42-47 p.57,1.17-21 p.57,1.44-48 p.57,1.48-54 p.58,1.1-13

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11. On 18th November 1982 the Court of Appeal of Hong Kong made an order granting final leave to appeal to Her Majesty in Council from the judgment of the Court of Appeal. On the application for leave it was agreed between the Appellant and the Respondent, by their Counsel, that, should the appeal succeed -

(a) each party should bear his own costs in respect of the appeal from the Board of Review to the High Court;

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(b) the Appellant should pay all of the Respondent's disbursements (including Counsel's fees) in respect of the appeal to the Court of Appeal; and

(c) the Appellant should pay the Respondent's taxed costs in respect of the appeal for her Majesty in Council.

THE RESPONDENT'S CONTENTIONS

12. The Respondent respectfully submits that the unanimous decision of the Court of Appeal, and the decision of the High Court, of Hong Kong should be upheld for the reasons appearing in the Judgments.

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13. (1) It is submitted that the profits ascertained in accordance with Part IV of the Ordinance are to be determined on principles basically similar to those applicable in determining the profits chargeable to income tax under Cases I and II of Schedule D in the United Kingdom.

(2) In regard to a trade, profession or business, the Hong Kong and U.K. systems lay the charge to tax on "profits" or "profits and gains". In each system there are specific statutory provisions which then modify the concept of profits. The relevant statutory modifications are similar in substance.

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(3) By contrast the general scheme in Australia provides for the taxation of the "gross income" less the "allowable deductions" of each tax payer, see per Dixon J. in New Zealand Flax Investments Ltd. v. F.C.T. (1938) 61 C.L.R. 179 at page 206. Section 51 of the Income Tax Assessment Act 1936-1973, which provides generally for the deduction of losses and outgoings, applies to income of all kinds and not only to business income.

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(4) The provisions of the Australian Act in sections 17, 25(E), 48 and 51, and Divisions 2 and 3 of Part III generally, contain a structure of taxation

fundamentally different, in regard to business profits, to those of Hong Kong and the U.K.

Record

10 (5) Although the profits tax in Hong Kong is a separate tax on the profits of businesses, whereas Cases I and II of Schedule D which tax the profits of businesses in the U.K. are part of a composite tax on income, the approach to the taxation of business profits is similar in substance in the two systems: the provisions in section 108, Schedule D, and sections 115(1), 130 and 137(1) of the Income and Corporation Taxes Act 1970 can be compared with those contained in sections 14, 15C, 16, 17 and 18B of the Hong Kong Ordinance. Section 126 of the Income Tax Act 1952 provided for tax under Cases I and II to be charged without any other deduction than allowed under the Act; this was repealed in 1969 as unnecessary, see Finance Act 1969, Schedule 21, Part X.

20 (6) The principles enunciated by the House of Lords in Southern Railway of Peru Limited v. Owen /1957/ A.C. 334 and the decision of the Court of Session in Inland Revenue Commissioners v. Titaghur Jute Factory Co. Ltd. /1978/ S.T.C. 166 in regard to the U.K. system are therefore, it is submitted, applicable to the Hong Kong system, are directly in point and should be followed and adopted in preference to the Australian authorities relied on by the Board of Review.

p.9,1.44-46

30 14. (1) It is further submitted that, even construing the relevant Hong Kong legislation without reference to the United Kingdom and Australian systems or the decisions on these, the deduction claimed by the Respondent should be allowed.

40 (2) By sections 14 and 18B of the Ordinance, subject to the provisions of the Ordinance the profits tax is levied on "profits" of an accounting year or year of assessment from trade, profession or business. The natural ordinary meaning of the word "profits" in relation to an accounting year and to a trade, profession or business is "gain over the year as determined by generally accepted principles of business accounting".

50 (3) The application of commercial principles to the ascertainment of profits for the purposes of the tax is supported by the provisions of section 15C of the Ordinance governing the valuation of trading stock on cessation of a business for the purpose of computing profits. These provisions presuppose that the value of trading stock is an element in ascertaining profits. Since there is no direct provision in the Ordinance for taking into account

the value of trading stock at the end of a relevant period (or, alternatively, any increase in the value of trading stock over the period) it must follow that this is to be brought into account as being inherent in the meaning of "profits" in Part IV of the Ordinance.

(4) The observations of Mills-Owens J. in C.I.R. v. Montana Lands Ltd. /1968/ H.K.L.R. 1 at page 24 and of Huggins J. in C.I.R. v. Hang Seng Bank Ltd /1972/ H.K.L.R. 484 at page 491 show the relevance of commercial practice in ascertaining profits assessable to tax. 10

p.24,1.36-37

(5) It is common ground that business accounting principles would require deduction of the provision for liability to make future payments claimed by the Respondent. The question then arises whether its deduction is prevented by section 16(1) of the Ordinance.

(6) It is submitted that the expression "outgoings and expenses ... incurred" in section 16(1) is to be construed widely so as to accord with ordinary business accounting principles. The observations of Mr. Justice Hunter in the High Court at pages 37-38 of the Record accord with the approach of Mills-Owens J. and Huggins J. referred to at (4) above. 20

p.37-38

(7) As to the meaning of "outgoings and expenses" it is submitted -

(a) The word "expenses" is capable of bearing a wide meaning - for example "the costs of earning the receipts of the year", see per the Lord President in Titaghur Jute at page 175e - and it should not merely mean "outgoings". Furthermore the expression "outgoings and expenses" must bear a meaning sufficiently wide to include the bad debts - that is, provisions writing off bad debts - referred to in section 16(1) (d). 30

(b) Section 16(1) limits the deduction of the "outgoings and expenses" to which it applies. It limits their deduction to the extent to which they are incurred "during the basis period in the production of profits". It would be rational for this limitation to extend to "outgoings and expenses" construed in a wide sense. In C.I.R. v. Mutual Investments Co. Ltd. /1967/ A.C. 587 at page 598D, your Lordships' Board regarded sections 16 and 17 as covering all the deductions made in ascertaining profits; this appears to involve reading "outgoings and expenses" as embracing all such deductions. 40 50

(c) In the context of ascertaining profits in a business accounting sense, the expression "outgoings and expenses" should therefore be construed as including ascertained liabilities, and liabilities to make future payments in certain events where on ordinary business accounting principles provisions would be made for such liabilities in arriving at profits.

10 (d) A wide meaning for "outgoings and expenses" in section 16(1) is supported by the express mention of "bad debts" in paragraph (d) of section 16(1) as one particular item in the "outgoings and expenses". The bad debts so deductible would in normal accountancy practice appear in the accounts as a provision for bad debts. Furthermore proviso (ii) of section 16(1)(d) shows that such bad debts may not be conclusively irrecoverable.

20 (e) As mentioned in (3) above section 15C presupposes that the value of trading stock is an element in ascertaining profits. Since there is no direct legislative provision for a deduction in respect of the value of stock at the beginning of a year (or in respect of a decrease over the year in the value of stock), it must follow either that the expression "outgoings and expenses" includes such a deduction, or that an adjustment is to be made otherwise than under section 16(1). Work in progress should logically be dealt with in the same way as trading stock, and the same conclusion therefore
30 applies to work in progress.

(8) The word "incurred" in section 16(1) should have a meaning appropriate to the width of the expression "outgoings and expenses" and apposite to the inclusion in that expression of provisions for bad debts and deductions for the opening value or a decrease in value of trading stock. In section 16(1)(d), it is used directly in relation to bad debts: in the opening general provision of section 16(1), it should have the same meaning. It is
40 submitted that this must therefore be the ordinary dictionary meaning, "come upon, arising" and not a technical meaning, such as "due and payable", that has no significance in regard to bad debt provisions.

(9) If, contrary to the submissions in (7) above, "outgoings and expenses" in section 16(1) bears a restricted meaning not including the provision claimed, section 16(1) would not apply at all to the provision claimed, and so would not limit or prevent its deduction. Moreover the reference to
50 "disbursements or expenses" in section 17(1)(b) of the Ordinance would fall to be construed with at least as restricted a meaning: section 17(1) would

therefore also not prohibit deduction of the provision. It is respectfully submitted that in that event the provision would fall to be deducted in the computation of the "profits" to be taxed under sections 14 and 18B, giving "profits" its normal business accounting meaning for the reasons set out in (2) to (4) above.

14. It is respectfully submitted that, unless such construction cannot be avoided, the Ordinance should not be so construed as to tax the subject on sums which commercial prudence requires him to set aside in respect of legal liabilities already incurred and attributable to the period in question and which in the case of a limited company ought not to be regarded as available for distribution. The Respondent respectfully adopts the approach of Lord Radcliffe in Southern Railway of Peru v. Owen [1957] A.C. 334 at page 352. 10

16. The Respondent humbly submits that the decision of the Court of Appeal and the decision of the High Court are correct and should be affirmed and that this appeal should be dismissed with costs for the following among other 20

R E A S O N S

(1) BECAUSE, as the Courts below have rightly held, upon a true construction of section 16(1) of the Inland Revenue Ordinance, cap. 112, the provision representing the liability for future staff retirement payments in the accounts of the Respondent for the year ended 31st December 1977 was an "outgoing" or "expense" "incurred" during the basis period for the year of assessment 1977 - 78. 30

(2) BECAUSE, regardless of whether or not that provision was deductible under the express terms of section 16(1), the "full amount of the profits" on which under section 18B the assessable profits are to be computed are the profits calculated on normal commercial accounting principles subject to such adjustments as are expressly required by the statute. 40

(3) BECAUSE, on a correct analysis, (a) the structure of the Hong Kong statute is, in relation to the ascertainment of profits chargeable to tax, similar to the structure of the United Kingdom legislation, and the reasoning of Lord MacDermott and Lord Radcliffe in Southern Railway of Peru v. Owen [1957] A.C. 334 and the opinions of the Court of Session 50

in Inland Revenue Commissioners v. Titaghur Jute Factory Co. Ltd. [1978] S.T.C. 166 are applicable to the construction of the Hong Kong Ordinance and directly in point;

Record

(b) the structure of the Australian statute is dissimilar and the Australian authorities are therefore not relevant.

(4) BECAUSE,

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(a) there was evidence in which the Board of Review could find or hold that the quantum of the provision was sufficiently accurate,

(b) the Board of Review did so find or hold, and

(c) in so finding or holding the Board of Review were making a finding of fact having addressed themselves to the correct legal principles.

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(5) BECAUSE the Judgments in the High Court and the Court of Appeal of Hong Kong were correct and ought to be affirmed.

P.W.E. TAYLOR

THEODORE WALLACE

IN THE PRIVY COUNCIL

O N A P P E A L
FROM THE COURT OF APPEAL OF HONG KONG

B E T W E E N :-

THE COMMISSIONER OF INLAND
REVENUE Appellant

- and -

LO & LO (a firm) Respondent

CASE FOR THE RESPONDENT

Messrs. Stephenson Harwood,
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Ref: 35/20/S20346

Solicitors for the Respondent