

HONG KONG COURT GIVES IMPORTANT GUIDANCE ON TAX APPEAL PROCEDURE

The Court of First Instance has given important guidance on the new procedure for taxpayers to appeal against tax decisions, and the threshold test that the court will apply in deciding whether to grant permission to appeal. The issue arose when considering whether sums paid to secure valuable mobile wireless spectrum should be considered as "revenue" or "capital" in nature.

BACKGROUND

In *China Mobile Hong Kong Co Ltd v Commissioner of Inland Revenue* [2018] HKCFI 373, China Mobile Hong Kong Co Ltd (the Taxpayer), a mobile telecommunication and related services provider, sought permission to appeal on the question of whether various lump sum spectrum utilisation fees (Upfront SUFs) paid by the Taxpayer to the Telecommunications Authority were "revenue" (as contended by the Taxpayer) or "capital" (as contended by the Inland Revenue) in nature. The payments in question were made in 2009 and, in return, the Authority granted licences to the Taxpayer to provide second generation 2G personal communications services and broadband wireless access 4G services respectively, following auctions for each set of services.

In its audited financial statements for the years ended 31 December 2009 to 2011, the Taxpayer classified the Upfront SUFs, totalling nearly HK\$510,000,000, as Non-Current Intangible Assets and amortised them on a straight-line basis over the relevant licence periods.

The Inland Revenue however disallowed the deduction of amortisation charges on the Upfront SUFs, assessing them as capital in nature and consequently raised additional profits tax assessments on the Taxpayer.

BOARD OF REVIEW APPEAL

The Taxpayer appealed to the Board of Review which held – in a decision recently published (Case No. D34/16) - that the Upfront SUFs were capital in nature. The Taxpayer's chief argument was that the wording of the Telecommunications Ordinance (the TO) is clear in showing that the Upfront SUFs are expenditure which should be considered as revenue and not capital in nature. Section 32I(1) of the TO provides that:-

"Subject to the consultation requirement under section 32G(2), the Authority may by order designate the frequency bands in which the use of spectrum is

Key issues

- The Court of First Instance has given important guidance on the new procedure for appeals against tax decisions.
- It is made clear that prospective appellant must "*identify and state precisely the question of law involved in each ground*" of the appeal.
- The threshold for the Court to grant permission to appeal is not high, merely requiring the appeal to have a "*reasonable prospect of success*", ie it is reasonably arguable.

subject to the payment of spectrum utilisation fee by users of the spectrum."
(underline supplied)

The Taxpayer argued that the Upfront SUFs were paid *for the use* of the radio spectrum, *not for the right* to use the radio spectrum. Accordingly, the Upfront SUFs are expenditure which is revenue in nature. The Board rejected this interpretation, ruling that it could not have been the purpose of the TO to give out *the right to use* radio spectrum free of charge, and to only impose charges on the *actual use* of the spectrum. By paying the Upfront SUFs, the Taxpayer acquired the exclusive right to use the assigned spectrum without the interference of competing mobile telecommunications operators.

The Board considered that the factors to be taken into consideration all pointed to the capital nature of the Upfront SUFs:

- The Upfront SUFs were incurred once and for the right to use the specified frequency bands during the periods respectively covered by the 2G and the 4G licences.
- The Upfront SUFs were paid with a view to creating an advantage for the enduring benefit of the Taxpayer's mobile telecommunications business in Hong Kong.
- The Upfront SUFs were the costs of enlarging, enhancing and strengthening the permanent profit-producing business structure of the Taxpayer and its income-generating capacity.

The Board therefore concluded that the Inland Revenue was correct in disallowing the deduction of amortisation charges on the Upfront SUFs.

The Taxpayer subsequently applied to the Court of First Instance under section 69(3)(a)(ii) of the Ordinance for permission to appeal against the Board's decision. It put forward a single question of law, namely whether the Upfront SUFs should be considered as revenue or capital payment. The principal point raised by the Taxpayer is that the Board had erred in finding the payments were capital in nature in that they were paid for the *right to use* radio spectrum and not for the *use* of the spectrum.

THE APPEAL THRESHOLD

Under the old section 69 of the Ordinance, a party dissatisfied with a decision of the Board could make an application requiring the Board to state a case on a question of law for the opinion of the Court of First Instance. Since 1 April 2016, however, a new appeal procedure has applied, under which an application is made to the Court by way of summons, supported by a statement setting out the grounds of the appeal and the reasons why permission should be granted. The Court must not grant leave to appeal unless it is satisfied that a question of law is involved in the proposed appeal and that the proposed appeal has a reasonable prospect of success or there is some other reason in the interests of justice why the proposed appeal should be heard (section 69(3)(e) of the Ordinance).

The Court held that a proposed appeal had a reasonable prospect of success if it was "*reasonably arguable*". It was not necessary to show that the proposed appeal would "*probably*" succeed. On this basis, the Court found that the proposed appeal was "*reasonably arguable*" and granted permission for the Taxpayer to appeal.

Despite the change in the appeal procedure, the Court held that the basic requirement that the appellant must identify and state a proper question of law for determination by the court remains.

As to what might constitute a "*proper question of law*" for the purpose of section 69, the Court provided useful guidance:

- i. The right of appeal under section 69 is not unqualified and absolute. Any proposed question of law must be proper and satisfy a "qualitative" aspect;
- ii. A question of law may superficially appear to be a question of law, but if it is general and vague and does not identify the issues to be argued, it is inadequate;
- iii. Simply turning the ultimate conclusion of the Board into the form of a question is not a proper question of law;
- iv. It would also not be a proper question of law if the framed question failed to identify precisely the point of law involved or any specific legal error or question; and
- v. Whether or not a proposed question is a proper question of law depends on the circumstances of the case.

The Court found the question identified by the Taxpayer, i.e. "*whether the Upfront SUFs should be considered as revenue or capital payment*" inadequate, as it merely turned the ultimate conclusion of the Board into a question. The statement was also inadequate in that it failed to identify and state precisely the question of law involved in each ground.

The Court did find, however, that the statement could be readily rectified to cure what was described as a "*technical deficiency*", and so ordered the Taxpayer to file in court and serve a fresh statement on the Commissioner.

COMMENTS

The Court's guidance on the new procedure for appealing against the Board's decisions is helpful. The requirement to state precisely the question of law involved in the appeal – together with confirmation that the threshold requirement of a "*reasonable prospect of success*" does not represent a high bar for permission to be granted – provides a clearer route for tax decisions to be reassessed.

The issue at the core of the dispute, i.e. whether sums paid in the course of a commercial transaction should be considered "revenue" (and therefore tax deductible), or capital in nature, will be decided in the substantive appeal. The Court of Appeal has recently given its view on the issue in the context of a land sale, with the majority deciding that the taxpayer had shown the requisite intention to trade and that the receipt should be liable to profits tax (see our client briefing, "[Hong Kong Court of Appeal considers whether receipt arising from the disposition of land is chargeable to profits tax](#)"). The substantive appeal in *China Mobile* is scheduled to be heard in September 2019.

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