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Cases for Troubled Times

Andrew Halkyard examines some recent tax cases, offering both good news and bad for Hong Kong businesses

In these unsettled economic times, I hoped that a trawl through recent case law could provide some unexpected relief from the current tax burden. Unfortunately, the reverse is generally true as the following cases illustrate.

Carrying on Business in Hong Kong

It is clear from recent Hong Kong case law that business can be carried on in Hong Kong with a very low level of activity. The Board of Review decision, D 107/96 12 IRBRD 83, (1997) HKRC §80-508, applying CIR v Barrica Investment Ltd (1996) HKRC §90-080, illustrates this.

In this case a Hong Kong trading company only had one customer, located outside Hong Kong. It had no Hong Kong employees. An individual outside Hong Kong made all its business decisions relating to the purchase and sale of goods. This person then instructed a corporate service provider in Hong Kong to carry out all the administrative work, such as drawing up and issuing purchase orders and pro forma invoices and arranging for the transfer of letters of credit, to implement those decisions. The Board of Review rejected the company’s claim that because (1) it was controlled outside Hong Kong, (2) it had no staff in Hong Kong, and (3) the activities of the service provider were merely ancillary administrative actions, then it did not carry on business in Hong Kong.

Instead, the Board held that carrying on business could not just depend on where the controller or central management was located. It concluded that the service provider was the company’s agent and that its actions, giving rise to binding legal obligations, were business activities of the company that took place in Hong Kong.

Once this very low threshold was satisfied, the Board of Review simply acknowledged that while the company’s activities may not have amounted to much, what it did in Hong Kong resulted in profits which were properly subject to tax. This decision will surely put a damper on the claims for tax-free status of Hong Kong-based trading companies touted by many of our corporate service providers.

Tax Losses for Individuals Speculating in Securities?

The trend of the Board of Review decisions in this area is well summarised in D 38/96 11 IRBRD 529 at 532, (1996) HKRC §80-471 as follows:

1. An isolated transaction outside a person’s ordinary business may amount to a trade. This is a question of fact to be decided on the circumstances of each case;
2. Where the question is whether an individual engaged in speculative dealings in securities is carrying on a trade, the prima facie presumption is no;
3. For dealings in securities or futures, there has to be a systematic course of dealing. This is a question of degree; and
4. Though it is not essential that a person carrying on a trade or business must have an office and staff and organisation, where some of these attributes exist, there must be other clear evidence of carrying on a trade or business.

Applying these principles, the Board in D 38/96 concluded that a loss claimed by the proprietor of a transport company in a one-off transaction in nickel futures, the taxpayer having no systematic operation or trading account, was not deductible as a trade or business loss of the transport company.

A similar decision was reached in D 111/97 13 IRBRD 20, (1998) HKRC §80-556 where the Board held that individuals would rarely be considered to carry on a trade or business in shares unless other associated trading or business activities were present. In this case the Board reviewed the authorities and concluded:

‘These cases show that the law places different weight on the taxpayer’s intention depending on the nature of the property purchased. One may question whether the distinction is justified in the circumstances we have nowadays in Hong Kong where speculation in landed properties is as prevalent and as unsophisticated as speculation in securities. Nevertheless, our duty is to apply the law as we understand it. Instead of looking only at the intention of the taxpayer, we must consider all the facts and ask ourselves whether [the taxpayer] did carry on a trade or business in the purchase and sale of shares. Our conclusion is that it was not. What the taxpayer did ... was in substance no different from what most people were doing in speculate in the stock market, without actually carrying on a trade or business.’

On the basis of these cases, it will be an uphill battle for an individual taxpayer seeking to successfully deduct losses from speculative activities in the securities markets. The only upside is that, in the fortunate event of making profits, the Commissioner will find it equally difficult to assess.
Incentive Payments to Enter into a New Lease

Decisions of the Full Federal Court of Australia in Selleck v FCT (1997) 36 ATR 558 and Montgomery v FCT (1998) 37 ATR 186 provide some comfort for businesses that receive an upfront payment upon moving premises and entering into a lease with a new landlord.

In both cases, a payment made by a lessor to a partnership as a contribution to the cost of fitting out newly leased premises was, in the circumstances of a forced move to those premises, a 'capital occasion' and not a gain made in the ordinary course of business.

These cases can be compared with the Privy Council decision, on appeal from New Zealand, in CIR (NZ) v Wattie & Lawrence [1998] STC 1160. In this case a lump sum payment, described by the court as a negative premium, was to be used for the purchase of existing leasehold premises. Lord Nolan, giving the judgment of the Privy Council, observed that a lump sum paid to secure the termination of an onerous lease with a substantial period still to run would be a capital payment. By way of analogy, Lord Nolan concluded that the premium was 'the mirror image' of such a payment and was, therefore, a non-taxable capital receipt.

As noted above, this series of cases provides some measure of good news for the dispossessed business tenant; the downside will be that such a payment made by the landlord will in all likelihood be regarded in the nature of capital and denied deductibility!

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我們了解的法律適用到案件，我們要
考慮的不僅是納稅人的意圖，我們要根
據所有案情來決定，詐騙內某人的索赔有
否經營股票買賣的貿易或商業，就本案
而言，我們認定納稅人沒有如此經營。
所做的事情，在實質上，與大多數參與股
票投資的其他所做的一樣，實際上並
未有涉及納稅行業或企業。」

根據本案，例如納稅人要成功地把其
在股票投資活動中招致的損失從應徵稅項
中扣減，將會相當然力。也許唯一的安慰
是，若納稅人僱用賺取利潤，稅務局局長
要向其徵稅時也會同樣感到舉步維艱。

以鼓勵簽立新租約的付款
一些公司或業主在覈理辦公室及與新業主
簽訂租約時，會事先收到一筆款項，對於
他們來說，以下兩宗案例應能去除他們的
憂慮。該兩宗案例分別是 Selleck v FCT
(1997) 35 ATR 558 及 Montgomery v FCT
(1998) 37 ATR 186，它們均由澳洲聯邦法
院全案審理。

在上述兩案中，出租人均向合夥業務給
予款項，作為該業務裝修其租用的單位所
需開支的一部分。鑑於情況與租客被迫進
入該單位沒有分別，故法院裁定所有合夥
業務所收的款項屬「資本增值」，而並非在
業務的通常運作中賺取的股本利潤。

上述案例與另一宗由澳洲聯上訴庭所
決定的案例 CIT (NZ) v Wattle & Lawrence
[1988] STC 1150 相比較。此案涉及的合夥
業務，收到一筆被法院形容為「負債費用」
的款項，並無關該業務同意接受一份
為期十二年的租金合約可作為租約。聯管
院的判決由 Lord Nolan 批評，判決指出，
若有關的款項是為了確保終止一份條款背
刻的租約而該租約期要延長長時期後才
會履行的話，該筆款項屬資本付款。聯
理院懇求鑑此，裁定案中的負債費用乃上
述資本付款的「鏡像」，因此屬於不需課
稅的資本收益。

正如上文所說，這一系列的案例可能替
那些被追討的商業租客帶來一些佳音。但
與此同時，業主所付出的款項很可能會被
視為資本性質，從而不能予以扣減。

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