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Judgment  
19, 1966

No. 42 of 1964

IN THE PRIVY COUNCIL

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O N A P P E A L  
FROM THE SUPREME COURT OF HONG KONG  
(APPELLATE JURISDICTION)

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B E T W E E N :

COMMISSIONER OF INLAND REVENUE Appellant

- and -

10 THE MUTUAL INVESTMENT COMPANY  
LIMITED Respondent

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CASE FOR THE APPELLANT

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1. This is an appeal from a judgment of the Full Court of the Supreme Court of Hong Kong (Appellate Jurisdiction) (Hogan, C.J. and Rigby, J.) dated the 25th January, 1964, allowing the Respondent's appeal against a judgment dated the 4th October, 1963 of the said Court in its original jurisdiction (Huggins, J.) which so far as is material to this present appeal allowed the appeal of the Appellant against a Decision of the Board of Review annulling in part assessments determined by the Appellant.

P. 35.

P. 12.

20 2. The question in this case is one of law depending upon the true construction of the provisions of the Hong Kong Inland Revenue Ordinance, Cap. 112, as to allowances for deductions in ascertaining a person's assessable profits. Under that Ordinance dividends from corporations which are themselves chargeable to Hong Kong profits tax are excluded from the assessable profits of any other person:  
30 the question here is whether or not the expenses of a person whose income consists in part of such dividends and in part of income liable to profits tax may be apportioned between the two types of income and the proportion of expenses attributable to the dividends disallowed as a deduction against that person's assessable profits. The Board of Review

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Record

decided that such apportionment and partial disallowance of expenses was incorrect. On appeal, Huggins, J. reversed this finding and on further appeal he in turn was overruled by the Full Court.

3. The relevant statutory provisions are:-

Inland Revenue Ordinance Chapter 112, Sections 2, 14, 15, 16, 17, 26, 51, 71, 75 and 77.

"2.(1) "assessable profits" means the net profits for the basis period arising in or derived from the Colony calculated in accordance with the provisions of Part IV but does not include profit arising from the sale of capital assets;"

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"basis period" for any year of assessment is the period on the income or the profits of which tax for that year ultimately falls to be computed.

"14.(1) Corporation profits tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every corporation carrying on trade or business in the Colony in respect of the profits of the corporation arising in or derived from the Colony from such trade or business.

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(2) Any sum arising in or derived from the Colony, other than a sum from the sale of capital assets, received by or credited to a corporation carrying on a trade or business in the Colony shall be deemed to arise from the trade or business carried on."

"15.(1) Business profits tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person other than a corporation carrying on a trade, profession or business in the Colony in respect of the profits of that person arising in or derived from the Colony from such trade, profession or business.

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(2) Any sum arising in or derived from the Colony, received by or credited to a person other than a corporation carrying on a trade, profession or business in the Colony shall be deemed to arise from such trade, profession or business:

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Provided that any such sum which -

- (a) is liable to interest tax under Part V; or
- (b) arises from the sale of a capital asset; or
- (c) is received by or credited to a person carrying on a trade, profession or business but which derives from his own personal property,

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shall not be deemed so to arise."

"16.(1) For the purposes of ascertaining the assessable profits of any person there shall be deducted all outgoings and expenses wholly and exclusively incurred during the basis period for the year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part".

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"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 -

- (b) any disbursements or expenses not being money expended for the purpose of producing such profits;"

"26. For the purposes of assessment under this Part -

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- (a) a dividend from a corporation which is chargeable to tax under this Part shall not be included in the assessable profits of any other person;"

"51.(1) An assessor may give notice in writing to any person requiring him within a reasonable time stated in such notice to furnish a return of any sum assessable to property tax, salaries, and annuities tax, profits tax and interest tax under Parts II, III, IV and V, containing such particulars and in such form as may be prescribed;

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"71.(1) Tax charged under the provisions of this Ordinance shall be paid in the manner

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directed in the notice of assessment on or before a date specified in such notice .....

"75.(1) Tax due and payable under this Ordinance shall be recoverable as a civil debt due to the Crown."

"77.(1) Where the Commissioner is of opinion that any person is about to or likely to leave the Colony without paying all tax assessed upon him..."

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P. 2 l.1 -  
P. 3 l.16

4. The Respondent was incorporated in Hong Kong on 23rd November, 1956. Its registered office is at 604, Edinburgh House, Hong Kong. It commenced business on the same day and acquired investments in the form of shares in the following companies:

1. Lee Hysan Estate Co. Ltd.	£370,000
2. Spa Food Products (F.E.) Ltd.	233,000
3. General Bottling Co. Ltd.	132,000
4. International Beverages Co. Ltd.	115,000
	<u>£850,000</u>

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Until the year ended 31st March 1959 the Respondent's only income was by way of dividends and a small amount of bank interest. For the years of assessment 1956/57 to 1959/60 the Respondent was assessed as being under no liability to tax. During the year ended 31st March, 1960 the Respondent borrowed money which it in turn lent out on interest to another company. There have been no other activities entered into by the Respondent and there have been no additions to or changes in the share investments. During the years ended March 30th 1960, and 1961, the Respondent received income by way of dividends and interest and incurred certain expenditure. In accordance with Section 26(a) of the Inland Revenue Ordinance the dividends were excluded from the assessable profits for the purpose of assessing the profits liable to tax for the years of assessment 1960/61 and 1961/62. After adding back the items of expenditure which he considered not allowable as deductions for tax purposes, the Assessor apportioned the balance of the expenses, in the proportion of the non-assessable income (i.e. the

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dividends) to the total income, and disallowed the sum so calculated as being expenses applicable to the production of non-assessable income.

10 5. Under Section 64 of the Inland Revenue Ordinance a person aggrieved by an assessment may appeal to the Appellant and the Respondent did so appeal. At this appeal the Assessor, having re-considered the apportionment of the expenses, was prepared to amend the assessments to allow the whole of the interest paid as a direct charge against the interest received, and to treat an amount of \$100 paid as a gratuity to an employee among the balance of apportionable expenses. The Appellant determined the assessment accordingly.

P. 3 l.17.

20 6. Under Section 66 of the Inland Revenue Ordinance a person dissatisfied with a decision of the Appellant may appeal to the Board of Review and the Respondent did so appeal. The Board of Review annulled the assessment so far as it disallowed expenditure which the Assessor had apportioned to the Respondent's non-assessable income.

30 7. The Appellant appealed against the decision of the Board of Review. His appeal was heard by the Supreme Court of Hong Kong (Original Jurisdiction) (Huggins, J.) on 15th and 16th July 1963 and judgment was delivered by the said Court on 4th October 1963. The Court held that that part of the Board's decision which annulled the Commissioner's assessment disallowing the deduction of expenses incurred in earning the dividends was not right and that these expenses were not allowable. After stating the arguments of the parties and considering the scheme of the Ordinance, Huggins J. concluded that he was left with no compelling guide to the correct construction of the Ordinance and said that he could not agree that its terms were plain. He had, however, come to a conclusion contrary to that of the Board. In his view the Crown was not seeking to impose double taxation in respect of the dividends, and he thought it would be reasonable and proper to exclude the expenses incurred in producing those dividends, if any warrant could be found for so doing. It seemed to him that looking fairly at the language of Section 51, the phrase "subject to the provisions of this Ordinance" in Section 14(1), the words "shall not

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P.31 l.40.

P.32 l.7.

P.32 l.26.

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be included" in Section 26(a) and the express directions in Section 16(1) and Section 17(1), the Ordinance did provide a warrant for the disallowance of the expenses in question.

P.33. 8. The Respondent appealed from this decision. The appeal was heard by the Full Court of the Supreme Court of Hong Kong (Appellate Jurisdiction) (Hogan C.J. and Rigby J.) on 27th, 28th and 29th November 1963 and on the 25th January 1964 the Court delivered judgment allowing the Respondent's appeal. (The Full Court also dealt with a cross-appeal by the Appellant as to allowances for depreciation in respect of a motor car belonging to the Respondent: no question now arises as to that.) 10

9. The Full Court after stating the arguments of the parties, considering the scheme of the Ordinance and comparing and contrasting the Ordinance with certain provisions of the United Kingdom income tax legislation expressed its conclusion as follows: 20

P.55 1.29 -  
P.56 1.56. "We would summarise our conclusions by saying that these dividends are part of the profits of the company and would only be excluded from such profits by the operation of some statutory provisions. Under the provisions of the Ordinance they are to be excluded from the assessable profits. There is nothing to say that they are to be excluded from the chargeable profits. The Ordinance indicates that chargeable profits and assessable profits are not the same thing and the terms of the Ordinance do not seem to us to show that the only distinction between them is that the assessable profits are limited by prescribed terminal points. Indeed if the only difference between chargeable and assessable profits is the period within which they are made, then one would expect to find, in the definition of assessable profits, the expression "chargeable profits" or its equivalent where, in fact, "net profits" appears. 30 40

We, like the judges in Hughes's case, [Hughes v. Bank of New Zealand (1938) A.C. 366] reach this conclusion with no sense of satisfaction because we can see no reason, logical, ethical or otherwise, why expenses incurred in earning profits which are not going to bear tax, should be deducted from those profits which are made assessable, but under the provisions of the

Ordinance, as amended in 1956, we can find no basis for excluding them."

10. The Appellant petitioned Her Majesty in Council on the 29th June 1964 for leave to appeal against the said judgment so far as it allowed the Respondent's said appeal. On the 3rd July 1964 an Order in Council was made granting the Appellant's petition.

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10 11. The Appellant humbly submits that this appeal should be allowed and that the Judgment of the Full Court of the Supreme Court of Hong Kong of the 25th January 1964 should so far as it concerns this appeal be set aside and the assessments of the Appellants which have been annulled by the Board of Review should be restored for the following among other

R E A S O N S

- (1) BECAUSE "profits" in Section 14 has no wider meaning than "assessable profits".
- 20 (2) BECAUSE the expressions "assessable profits" and "profits in respect of which [a person] is chargeable to tax" in Section 16 refer to profits of the same kind, the distinction between them being that assessable profits are identified by reference to the period for which they are assessable and profits in respect of which a person is chargeable by reference to that person.
- 30 (3) BECAUSE since dividends are excluded from "assessable profits" by Section 26, expenses incurred to earn dividends cannot be expenses incurred in the production of "profits in respect of which [a person] is chargeable to tax" under Section 16.
- 40 (4) BECAUSE under the Ordinance a person is said to be charged to tax and tax is said to be charged on a person's assessable profits, (being the profits in respect of which such person is said to be chargeable identified by reference to a period of time), and the only expenses which may be deducted in computing such person's assessable profits are those incurred in the production of the profits in respect of which such person is chargeable to tax and not those incurred in producing

profits in the form of dividends on which no tax is charged.

- (5) BECAUSE the judgment of Huggins, J., upon this question is right.
- (6) BECAUSE the judgment of the Full Court upon this question is wrong.

H. H. MONROE

RODERICK WATSON.



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COMMISSIONER OF INLAND  
REVENUE Appellant

- and -

THE MUTUAL INVLSMENT  
COMPANY LIMITED Respondent

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CASE FOR THE APPELLANT

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