

IN THE PRIVY COUNCIL

No 9 of 1977

O N A P P E A L

FROM THE COURT OF APPEAL OF HONG KONG

B E T W E E N :

COMMISSIONER OF INLAND REVENUE Appellant

- AND -

FAR EAST EXCHANGE LIMITED Respondent

CASE FOR THE RESPONDENT

RECORD

10

1. This is an appeal from a judgment of the Court of Appeal of Hong Kong (Briggs CJ., McMullin and Leonard, JJ.) dated 5th October 1976 on a Case Stated by the Board of Review constituted under the Inland Revenue Ordinance Chapter 112 of the Laws of Hong Kong (hereinafter referred to as "the Ordinance"). Such judgment affirmed with costs the decision of the Board of Review dated 10th March 1975 allowing the Respondent's appeal against the determination of the Commissioner of Inland Revenue that for the year of assessment 1971/2 in addition to the assessable profits shown on its tax return the Respondent should be assessed on additional assessable profits in the sum of HK\$4,880,000 with tax payable thereon of HK\$732,000.

P.41

Ps.1-6

20

2. The said sum of HK\$4,880,000 consists of entrance fees paid to the Respondent by its members. The question for decision is whether such entrance fees are chargeable to profits tax under the Ordinance.

30

3. The relevant provisions of the Ordinance are sections 14 and 24, which, as in force at the material time, provided as follows:-

"Section 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

RECORD

trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.

- Section 24:
- (1) Where a person carries on a club or similar institution which receives from its members not less than half of its gross receipts on revenue account (including entrance fees and subscriptions), such person shall be deemed not to carry on a business; but where less than half of its gross receipts are received from members, the whole of the income from transactions both with members and others (including entrance fees and subscriptions) shall be deemed to be receipts from a business, and such person shall be chargeable in respect of the profits therefrom. 10
 - (2) Where a person carries on a trade, association in such circumstances that more than half its receipts by way of subscriptions are from persons who claim or would be entitled to claim that such sums were allowable deductions for the purposes of section 16, such person shall be deemed to carry on a business and the whole of the income of such association from transactions both with members and others (including entrance fees and subscriptions) shall be deemed to be receipts from business, and such person shall be chargeable in respect of the profits therefrom. 30
 - (3) In this section, "members" means those persons entitled to vote at a general meeting of the club, or similar institution, or trade association." 40

P.4
L5-12

4. It is admitted that the Respondent was a person carrying on a trade association in such circumstances that more than half its receipts by way of subscription were from persons who claimed or would be entitled to claim that such sums were allowable deductions for the purposes of section 16 of the Ordinance [deductions in computing chargeable profits of their own businesses], within the meaning of sub-section (2) of section 24, so that the Respondent was deemed to carry on a business, and so that the whole of the income of the Respondent (including entrance fees and subscriptions) was deemed to be receipts from business, and so that the Respondent was 50

chargeable in respect of the profits therefrom. The questions which arise in this appeal are whether the entrance fees in this case were of a capital nature, and if so whether their capital nature excluded them from the charge of profits tax. The Board of Review and the Court of Appeal of Hong Kong answered their questions affirmatively in favour of the Respondent and annulled the assessment.

- 10 5. The Respondent was incorporated on 31st October 1969 under the Companies Ordinance Chapter 32 as a company limited by guarantee and not having a share capital. Its objects included the provisions of a securities market place, the establishment of an exchange or place of meeting for stock and share brokers, the acquisition of suitable premises for a stock exchange and the carrying on in the premises so acquired of the business of a stock exchange. P.1 L.29 Ps. 48-51
- 20 6. The Respondent's memorandum and articles of association were altered by a special resolution passed on 24th November 1970. Its memorandum and articles of association prior to and after such alteration were both annexed to the Case Stated by the Board of Review and are now contained in the Record. The set relevant to this appeal is that after alteration. The following provisions of the articles are directly relevant:- P.85 Ps.46-83 Ps.84-119 Ps.84-119
- (a) The number of members was limited to one hundred and fifty (article 2). P.92 L.16
- 30 (b) Each original member had to pay an entrance fee (in addition to his monthly subscription) (articles 5 and 11). P.94 L.27
- 40 (c) A member resigning, or the personal representative of a member dying, or the trustee in bankruptcy of a member becoming bankrupt, had a right to nominate a person to take the place of such resigning, deceased or bankrupt member. If the person nominated was elected as a member, he was not required to pay any entrance fee. Any amount which the person nominated had agreed to pay to a resigning member, or the personal representative of a deceased member, or the trustee in bankruptcy of a bankrupt member, was to be paid to the Respondent who had to pass the amount on to such resigning member, personal representative or trustee in bankruptcy, subject only to deduction of amounts which might be owing to the Respondent or other members (articles 16 to 18) P.95 L.37 P.96 L.38-
- 50 (d) If no nomination was made by a resigning member, P.97 L.37

RECORD

- P.97.L.41 the personal representative of a deceased member, or the trustee in bankruptcy of a bankrupt member, the Respondent was able to fill the vacancy, but was required to pay to such resigning member, personal representative, or trustee in bankruptcy any moneys received from such new member subject only to deduction of amounts which might be owing to the respondent or other members (article 20). 10
- P.97.L.38 (e) If any member was expelled from membership, there was a vacancy in the membership (article 19).
7. It will be seen from the provisions of the articles of association summarised in the preceding paragraphs that the benefit of a seat on the stock exchange which a member received by paying his entrance fee secured for his benefit and that of his successors except in the event of expulsion, and that the Respondent having once sold the limited number of seats could not sell a seat again except in the event of a vacancy on a member's expulsion. 20
- P.3 L.8 8. The Assessor appointed under the Ordinance assessed the Respondent to profits tax for the year of assessment 1971/72 on entrance fees received in the period on the profits of which that assessment was based after an unsuccessful appeal to the Commissioner of Inland Revenue and the Respondent appealed to the Board of Review. On 10th March 1975 the Board of Review allowed the Respondent's appeal and annulled the assessment. Its decision was stated in paragraph 17 of the Case Stated in these terms: 30
- P.3 L.19
- P.5.L.32
- P.5.L.34
- "..... We found that the sum of \$4,880,000 derived from entrance fees would not be chargeable to profits tax if it consists of receipts of a capital nature but would be chargeable if it consists of receipts of an income nature. We further found that the Taxpayer's accounts, audited by Chartered Accountants, show the entrance fees to be capital assets and that this would appear to accord with standard accounting practice. We consider that the Commissioner had an onus upon him to prove that the entrance fees are of an income nature and thus eligible to tax and that he had not discharged this onus." 30
- Ps.1-6 9. On the Appellant's application the Board of Review stated a case pursuant to section 69 of the Ordinance and posed three questions of law (which are set out in paragraph 11 below) for the opinion of the Court.

10. The Appellant's appeal on the Case Stated by the Board of Review was heard by the Court of Appeal of Hong Kong (Briggs C.J., McMullin and Leonard, JJ.) on 13th and 14th September 1976.

11. On 5th October 1976 the Court of Appeal of Hong Kong gave judgment dismissing the appeal with costs and answering the questions posed by the Case Stated as follows:-

Ps.41-42
P.24.L.14-
P.25.L.11

10 "(1) Did the Board err in law in finding that the sum of \$4,880,000 derived from entrance fees would not be chargeable to profits tax if it consists of receipts of a capital nature?

P.39.L.26
P.40.L.16

A. No, because they consisted not only of receipts of a capital nature but also of profits arising from the sale of capital assets.

20 (2) Is there any or any sufficient evidence to support the Board's finding that the taxpayer's accounts show the entrance fees to be capital assets?

A. The accounts themselves do not so show them. They do however show them to be capital items.

(3) Did the Board err in law in failing to find that the entrance fees were of an income nature?

30 A. No. The construction of section 24(2) is such that had the profits arising from them been found not to be profits resulting from the sale of capital assets they would be taxable not because they were of an "income nature" but because they were deemed to be receipts from business and the Respondent would have been chargeable in respect of the profits from them. This does not arise since I regard the profits arising from their receipt to be profits from the sale of capital assets."

12. Separate judgments were delivered by Leonard, J. and McMullin, J. Briggs CJ. said that he was in complete agreement with both judgments.

Ps.7-25
Ps.26-39
P.40

40 13. Leonard J. concluded that the Respondent's articles recognised the ownership of a seat as a saleable asset. He noted that this differed radically from the London Stock Exchange and other similar Exchanges where the right or privilege which a member acquired was simply the right to be admitted to the Stock Exchange building to transact the business of a broker and jobber for the year.

Ps.7-25
P.9.L.19
P.10.L.13

RECORD

P.15.L.20

He held that section 14 did not impose a charge on profits of a capital nature because profits of a capital nature could not truly be said to arise from a trade profession or business as distinct from its cessation or reduction; he agreed that the reference to profits arising from the sale of capital assets in section 14 might have been inserted ex abundante cautela.

P.14.L.17

P.19.L.46

After examining the facts of the case and various judicial authorities he came to the conclusion that entrance fees were of a capital nature. He then proceeded to analyse section 24(2). He decided that the word income in the phrase "the whole of the income of such association (including entrance fees and subscriptions) shall be deemed to be receipts from business" meant "receipts" or "incomings" and so included the entrance fees even though of a capital nature. But he held that the Respondent was selling capital assets, so that the entrance fees were excluded from the charge imposed by section 14, unless brought in by section 24. He considered various possible arguments and counter-arguments as to the relationship between sections 14 and 24 without coming to any firm conclusion in principle, but expressed himself as satisfied that the two sections read together did not clearly evince an intention to tax the subject on profits from entrance fees that were the consideration for the sale of capital assets.

P.20.L.23-
P.22.L.17

P.23.L.6-
P.24.L.7

P.23.L.25

P.24.L.7

Ps.26-39
P.31.L.8
P.36.L.12
P.38.L.33

14. McMullin, J. held that section 14 did not impose a charge on profits of a capital nature. He was satisfied that the entrance fees were of the nature of capital, being the sale price of a seat by the Exchange. He concluded that such fees were to be regarded as the Respondent's profits arising from the sale of capital assets and therefore expressly excluded from charge under section 14 and correspondingly excluded from the phrase "(including entrance fees and subscriptions)" in section 24(2).

15. The Respondent contends that the entrance fees were of a capital nature because (i) they were received in return for the benefit of a seat on the stock exchange, (ii) they were non-recurrent, and (iii) it was found as a fact by the Board of Review that treatment of the entrance fees as capital in the Respondent's accounts accorded with standard accounting practice. It is submitted that section 24 of the Ordinance does not cause entrance fees of a capital nature to produce chargeable profits, whether or not such entrance fees arise from the sale of capital assets. In this respect the Respondent respectfully

asks Her Majesty in Council to go further than Leonard, J., who thought that the capital character of the fees was not in itself sufficient to prevent the fees from being chargeable to profits tax, and further than McMullin, J., who thought that entrance fees might be chargeable to profits tax notwithstanding their capital character if they were not derived from the sale of capital assets. The reasons why the Respondent contends that section 24 does not cause entrance fees of a capital character to produce chargeable profits are:-

Ps.7-25

Ps.26-39

10 (a) With respect to the opinion of Leonard, J., the Respondent contends that the word "income" in section 24 is used in contradistinction to capital, so that the entrance fees which are included in the income of a trade association are only those which have a revenue character.

20 (b) In the alternative, if the word "income" means "incomings" and includes entrance fees of a capital character, the consequence is merely to deem them to be receipts from business, not to deprive them of their capital character. Being business receipts on capital account, they do not give rise to profits within the meaning of section 24, since the reference to profits in section 24 (a) is to profits from a trade chargeable to profits tax under section 14 and capital profits are not so chargeable, or (b) should be construed to mean profits of a revenue nature since the scheme of the Ordinance is to tax yield and not capital profits.

40 16. If the Respondent should be wrong in his contention that entrance fees fail to produce chargeable profits merely because they have a capital character, he respectfully asks Her Majesty in Council to uphold the decision of the Court of Appeal of Hong Kong that the entrance fees were profits arising from the sale of capital assets, and as such were excluded by section 14 of the Ordinance from the charge to profits tax, either because section 14 alone was the charging section or because section 24 was not to be read as bringing into charge profits which were expressly excluded from chargeability by section 14.

17. The Respondent respectfully submits that this appeal should be dismissed with costs for the following among other.

R E A S O N S

1. BECAUSE the entrance fees were of a capital nature.
2. BECAUSE the entrance fees represented profits arising from the sale of capital assets.
3. BECAUSE section 24 of the Ordinance does not include entrance fees of a capital nature in the income of a trade association.
4. BECAUSE entrance fees of a capital nature even if deemed to be receipts from business under section 24(2) produce capital profits which are not chargeable to profits tax under section 14 and/or section 24(2). 10
5. BECAUSE profits arising from the sale of capital assets are excluded from the charge of profits tax under section 14 of the Ordinance and are not brought into charge by section 24.
6. BECAUSE the decision of the Court of Appeal of Hong Kong was right and should be upheld.

C.N. BEATTIE

20

ANDREW LI.

IN THE PRIVY COUNCIL No. 9 1977

ON APPEAL
FROM THE COURT OF APPEAL HONG
KONG

B E T W E E N :

COMMISSIONER OF INLAND REVENUE
Appellant

- AND -

FAR EAST EXCHANGE LIMITED
Respondent

CASE FOR THE RESPONDENT

SLAUGHTER AND MAY,
35, Basinghall Street,
London, EC2V 5DB.
Ref: GFR/KIT/BK
Tel: 600 1200
Solicitors for the Respondent