

38/84

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 :

KOWLOON STOCK EXCHANGE LIMITED Appellant

and

COMMISSIONER OF INLAND REVENUE Respondent

CASE FOR THE APPELLANT

Record

10

1. This is an Appeal from a Judgment of the Court of Appeal of Hong Kong (Leonard V-P, Cons and Barker JJA) delivered on 13th July 1983 whereby the Appellant's appeal was dismissed and each of the questions of law set out in a Case Stated by the Hong Kong Board of Review was answered in favour of the Respondent.

p.22

20

2. The issues raised before the Court of Appeal and on this Appeal depend upon the proper construction of the provisions of S.24(1) and (2) of the Inland Revenue Ordinance, Cap. 112 ("the Ordinance"). Those statutory provisions, at the material time, read as follows:

30

"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.

Record

(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." 10

3. The issues raised by this appeal are:

- (1) Whether the Appellant carried on "a club or similar institution" within the meaning of S.24(1) of the Ordinance ("the club issue");
- (2) Whether the Appellant carried on "a trade association" within the meaning of S.24(2) of the Ordinance ("the trade association issue"); 20
- (3) Whether the sums paid to the Appellant by its members by way of entrance fees and founders' contributions were "subscriptions" within the meaning of S.24(2) of the Ordinance ("the subscriptions issue").

p.22:12-15 4. The Appellant is a company limited by guarantee and was incorporated in Hong Kong on 10th March 1970. The Appellant opened its premises to members for their business on 5th January 1972. 30
p. 7:21
p.22:16 The principal objects of the Appellant are set out
p.23:15 in the Memorandum of Association at paragraph 3(a) to (f).

5. The effect of Clauses 2, 3 and 29 of the Articles of Association is that a Committee of 14 Founder Members and 10 other Members elected by the membership manages and controls the affairs of the Appellant. Election of members whose number is restricted to 150 is in the hands of the Committee. 40
At all material times, upon election each new member was asked to pay an entrance fee of \$20,000 and a monthly subscription of not more than \$500. All sums herein are stated in Hong Kong dollars.

6. By Notice of Assessment dated 6th September 1973, for the year of assessment 1971-72, the Respondent computed the Appellant's assessable profits in the sum of \$3,085,022 and profits tax in the sum of \$462,753. The computation of these assessments is set out in paragraph 4 of the Case Stated by the Board of Review. 50
p.8:12-39

Record

7. On 24th September 1973 the Appellant lodged an objection to the assessment. The Commissioner, in his Determination, rejected the Appellant's objection and, exercising his discretion under S.18(7) of the Ordinance increased the Appellant's assessable profits to \$5,701,211 and the tax thereon to \$855,181. The Appellant thereupon appealed to the Board of Review. The grounds of appeal included grounds relating to the three issues set out in paragraph 3 hereof. p.8:40-46
p.9:5-10
p.9:10
- 10
8. The Board of Review gave its decision on 22nd May 1980. The Board decided the said three issues in favour of the Respondent, but found that the Appellant had commenced business on a later date than that determined by the Respondent and remitted the case to the Respondent for the assessment to be revised to reflect such later date of commencement of business. p.20:12
9. The Court of Appeal gave leave under S.69A of the Ordinance for a case to be stated for its consideration. The case stated encompassed the three issues set out in paragraph 3 hereof. p.32:31-36
p.21:12-30
- 20
10. On the club issue, the Court of Appeal found that the Appellant's constitution and organisation were much the same as many sporting, political and other clubs, but held that "a club" is "an association formed for other than business purposes" and that any association which has a predominant intention the financial benefit of its members could not be a club or similar institution within S.24(1) of the Ordinance. The Appellant was held to be such an association. p.23:41-43
p.26:18
p.26:22
- 30
11. On the trade association issue, the Court of Appeal decided that in view of the different structures of the United Kingdom and Hong Kong Tax Laws they were able to draw "little if any" assistance from the definition given to "trade" in the United Kingdom authorities. The Court of Appeal held that trade was to be given a more restricted meaning under Hong Kong law than it has under United Kingdom law and, specifically, that trade should be restricted to the buying and selling of goods. The Court of Appeal went on to hold that a stockbroker was a trader within such definition and that as the Appellant both provided specific services for its members and watched over their interests it was a trade association. p.28:38-44
p.29:17-35
p.29:36-42
p.30:23-38
- 40
12. On the subscription issue, the Court of Appeal held that on a true construction of the p.32:4-17
- 50

Record

p.32:21-23 word "subscription" in its context, members' entrance fees are excluded therefrom and that "on balance" founders' contributions, being similar in their nature to entrance fees, should also be excluded. The Court of Appeal held that in any event the position in relation to founders' contributions "would have made no material difference".

p.36 13. By Order dated 29th July 1983 the Court of Appeal granted the Appellant leave to appeal to Her Majesty in Council in respect of their said judgment, conditional upon the matters set out in the said order. 10

THE CLUB ISSUE

14. The Court of Appeal should have held that the Appellant was a "club or similar institution" within the meaning of S.24(1) of the Ordinance. The Appellant's principal contentions are, first, that for the reasons stated below a broader approach than that taken by the Court of Appeal should be adopted in determining whether an association falls within the statutory provision; and, secondly, that if, contrary to the Appellant's contention, a purpose of profit or gain prevents an association from being a club or similar institution it is important to distinguish the object of the Appellant from the objectives of its members. 20

p.18:12 15. The Court of Appeal gave undue emphasis to that feature of the definitions of "club" recited in its Judgment which required that the purpose of the association must not be gain or profit. An association of persons is not inevitably prevented from being a club by reason of the fact that the association has such a purpose. Proprietary clubs, shop clubs and investment clubs are examples of associations which are conventionally classified as clubs despite the fact that they are formed for the purpose of gain or profit (see Halsbury's Laws of England, 4th Edition Vol. 6 paras. 208-216). The Board of Review conceded that such associations are recognised as clubs in spite of their having such a purpose. 30 40

25:41 16. The Court of Appeal placed considerable reliance upon the definitions or descriptions of "club" given by Griffiths C.J. in The Bohemians Club v The Acting Federal Commissions of Taxation (1918) 24 CLR 334 and Dixon J. in Bennett v Cooper (1948) 76 CLR 570. In the former case the High Court of Australia had to determine whether the annual subscriptions of the members of the Bohemians Club constituted taxable income within the meaning of the Income Tax Assessment Act 50

1915-1918. There was no issue as to the nature of the Bohemians Club, which was accepted by all parties as constituting a club. The description a club given therein by Griffiths C.J. was referred to in the speech of Lord Wilberforce in Fletcher v Income Tax Commissioner (1972) A.C. 414 at p. 422 but such reference did not constitute express approval of the description and even less did it constitute endorsement of the description as an accurate definition for general purposes. In Fletcher the Privy Council was concerned to determine whether certain receipts of a bathing club in Jamaica were assessable to tax; it was accepted that the bathing club was a members' club. In Bennett v Cooper (supra) the High Court of Australia had to determine whether a fraternal Order, organised in Lodges, constituted a club for the purpose of a very different statutory provision, namely S.203 of the Licensing Act 1911-46 which provided that the supply of liquor on the premises of an unregistered club constituted an offence; Dixon J. said (at p.579) that the definition of the word "club", "must depend upon common understanding coupled with the purpose of the enactment" and possessed "a very wide and flexible meaning".

17. It is submitted that assistance is to be gained in determining the scope to be given to the phrase "club or similar institution" by consideration of the general legislative intent of S.24(1) of the Ordinance. The doctrine known as the "mutuality principle" applies to groups of persons who make contributions towards a common purpose and provides that such groups are not liable to tax on any surplus over expenditure (New York Life Assurance v Styles (1889) 14 App. Cas. 381). If, however, an association which is subject to the mutuality principle trades with non-subscribers the profits of such trade are taxable (Carlisle and Silloth Golf Club v Smith (1913) 3 K.B. 75). The purpose and effect of S.24(1) is substantially to curtail the application of the Carlisle and Silloth Golf Club decision; the sub-section introduces a statutory rule of thumb whereby either all or none of the monies which an association receives from its members become chargeable to tax. Members' clubs constitute the best example of organisations governed by the mutuality principle. S.24(1) in its reference to "similar institutions" is directed, it is submitted, at organisations other than clubs which would be subject to the mutuality principle. Associations to which this principle has been applied may be involved in trading activity (see Lord Wilberforce in Fletcher,

Record

supra, at p. 421). It is submitted that in view of the provisions of its Articles of Association the Appellant would, but for S.24(1), be subject to the mutuality principle and that if the Appellant is not a club within the meaning of S.24(1) it falls within the category of a "similar institution". It is respectfully submitted that the foregoing provides an explanation for the inclusion of the words "similar institution" the meaning of which, as the Court of Appeal found, is otherwise difficult to envisage.

27:2

10

18. A critical distinction is to be drawn between the object of the club itself and the purposes, motives and objectives of its members. The descriptions or definitions of the word "club" upon which the Court of Appeal relied are directed to the object of the club rather than to the purpose of its members and do not support the Court of Appeal's assertion that gain or profit to its members is "the dominant exclusionary feature of a club". The Court of Appeal cited a passage in Daly's Club Law, 7th Edition; a further passage therein reads (at pp 6 to 7):

27:6

20

"It should be understood that what has been said above about the general run of trading clubs does not mean that there cannot be such an association with the true characteristics of a club, but such exceptions from the general rule are more likely to be members clubs than proprietary clubs. A gardening or photographic club for instance may be formed largely - or conceivably exclusively - for the purpose of obtaining goods at reduced prices by bulk buying. The difference in such a case is that rights and liabilities are created between the members arising from their association together."

30

This illustration points up the distinction between the object of the club and the purposes of its members. It is further submitted that any test which requires the careful scrutiny of the purposes, motives and objectives of members prior to the creation of an association would be onerous and unworkable and therefore wholly unsatisfactory. The objects of the Appellant are set out in its Memorandum of Association by which the Appellant's powers are legally circumscribed. The Memorandum of Association makes no provision for the Appellant to make gain or profit. And it has not been contended that such is the purpose of the Appellant. In consequence, if contrary to the Appellant's contention a purpose of gain or profits defeats the characterisation of an association as "a club or similar institution" within the meaning of S.24(1),

40

50

it is in any event contended that the Appellant has no such purpose.

Record

THE TRADE ASSOCIATION ISSUE

19. The Court of Appeal should have held that the Appellant was not carrying on "a trade association" within the meaning of S.24(2) of the Ordinance.

10 20. The definition of "trade" in S.2(1) of the Ordinance - "it shall include every trade and manufacture and every adventure and concern in the nature of trade" - is of limited assistance. 27:32
The Appellant respectfully accepts the Court of Appeal's hesitation about relying on the definition of trade in the United Kingdom authorities by reason of the difference between the structure of the United Kingdom tax laws and the Ordinance and that a restrictive interpretation is to be given to the word "trade" in S.24(2). S.24(2) in its relevant (unamended) form 28:38
20 made no reference to professional or business associations, in contra-distinction to the charging section of the Ordinance (S.14) which refers to "every person carrying on a trade, profession or business" as do other sections in the Ordinance. It is necessary therefore to distinguish between "trade" on the one hand, and "profession" or "business" on the other. The fact that S.24(2) is a charging section by way of a "deeming" provision is a further reason for giving the words "trade association" a restricted meaning. The Appellant further respectfully accepts that "trade" should be restricted to the buying and selling of goods.

30 21. But it is contended that the stockbroker members of the Appellant are not "traders", so construed, and that in consequence the Appellant is not "a trading association" within the meaning of S.24(2). Although a stockbroker of course engages in the buying and selling shares, he does so only as an agent for his clients and this is only one of the functions which he performs for his clients; he also exercises specialist professional skills in giving advice to such clients. The scope of the word "business" is wider than that of the word "trade" (Re a Debtor (1927) 1 Ch. 97 and Re a Debtor (1936) 1 Ch 237) and stockbrokers are properly to be regarded as carrying on a business (or a profession) rather than carrying on a trade.

50 THE SUBSCRIPTIONS ISSUE

22. The Court of Appeal should have held that the

members' entrance fees and the founders' contributions were "subscriptions" within the meaning of S.24(2) of the Ordinance.

23. Contrary to that which the Court of Appeal held, it is submitted that if either the entrance fee or the founders' contributions are "subscriptions" within the meaning of S.24(2) the "deeming" provision is inapplicable to the Appellant. This follows from the fact that the quantum of the founders' contributions (and of the entrance fees) was considerably greater than the members' monthly subscriptions. 10

24. The word "subscriptions" should be given its natural and ordinary meaning. By such meaning the word embraces both once-for-all payments and periodic payments. Indeed the Court of Appeal so found. It is submitted to give a limited meaning to "subscriptions" in S.24(2) is inappropriate in the context of a deeming provision in a tax statute. Entrance fees and founders' contributions should both properly be considered as lump sum subscription payments. 20

p.52:8

25. The founders' contributions entitled the founders to become Members of the Appellant and Members of the Committee for life: Art. 28(d) of the Articles of Association. In the circumstances therein set out founders were freed from the obligation to pay any further subscriptions. In consequence founders' contributions were recognised by the Articles as being receipts in the nature of subscriptions and as representing fully paid up subscriptions. 30

26. The Appellant respectfully submits that this appeal ought to be allowed with costs for the following (amongst other)

R E A S O N S

- (1) BECAUSE the Appellant carries on "a club or similar institution" within the meaning of S.24(1) Inland Revenue Ordinance.
- (2) BECAUSE the Appellant does not carry on "a trade association" within the meaning of S.24(2) of the Ordinance. 40
- (3) BECAUSE the sums paid to the Appellant by its members by way of entrance fees and/or founders' contributions were "subscriptions" within the meaning of S.24(2) of the Ordinance.

GEORGE NEWMAN, Q.C.

MARK STRACHAN

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 :

KOWLOON STOCK EXCHANGE LTD.

Appellant

- and -

COMMISSIONER OF INLAND REVENUE

Respondent

CASE FOR THE APPELLANT

Philip Conway Thomas & Co.,
61 Catherine Place,
London SW1E 6HB.

Solicitors for the Appellant