38/84

IN THE PRIVY COUNCIL No. 1 of 1984

ON APPEAL

FROM THE COURT OF APPEAL OF HONG KONG

BETWEEN:

KOWLOON STOCK EXCHANGE LIMITED Appellant

- and -

COMMISSIONER OF INLAND REVENUE Respondent

CASE FOR THE RESPONDENT

RECORD

1. In Hong Kong the Inland Revenue Ordinance (in force since 1947) imposes a tax, similar to United Kingdom income tax, on property, earnings, profits and interest. The present appeal concerns profits tax, which is contained in Part IV (Sections 14 to 27) of the Inland Revenue Ordinance, and is primarily imposed by Section 14 in the following words:

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

2. The issue in this appeal is whether the above-named Appellant, Kowloon Stock Exchange Limited ("the Appellant"), can escape profits tax for the year of assessment 1971/1972 by reason of Section 24 of the Ordinance (1971 Edition) on the ground that: p.11 ll.5-20

(i) the Appellant carried on "a club or similar institution" within the meaning of Section 24(1), which received from its members not less than half its gross receipts on revenue account, and thus "shall be deemed not to carry on a business"; and

(ii) the Appellant did not carry on a "trade

association" within the meaning of Section 24(2) and thus was not (if it did not otherwise carry on a business) deemed to carry on a business under Section 24(2); and

(iii) if the Appellant did carry on a trade association nevertheless the circumstances allow the Appellant to escape from Section 24(2), because its receipts by way of subscriptions in the period in question were as to no more than half thereof "by way of subscriptions ... from persons ..." of the type mentioned in Section 24(2).

3. The course of litigation so far has been as follows:

(i) On 6th September, 1973 the Respondent gave notice of assessment to the Appellant for the year of assessment 1971/1972; and, the Appellant having made an objection to the assessment pursuant to Section 64(1) of the Ordinance, the Respondent on 14th September, 1974 made a determination pursuant to Section 64(4), that the Appellant should be assessed for profits tax for the year of assessment 1971/1972 on assessable profits of $5,701,211, the tax thereon being $855,181. The said sum of $5,701,211 represented founders' contributions and members' contributions (i.e. entrance fees) paid to the Appellant by its members, after allowance for a loss in respect of other items not material to this appeal.

(ii) The Appellant appealed to the Board of Review, on a number of grounds and the Board of Review dismissed the Appellant's appeal in all respects material to this appeal. It is provided by Section 68(4) that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the Appellant.

(iii) Section 69(1) provides that the decision of the Board of Review shall be final, provided that either party may require the Board to state a case on a question of law for the opinion of the High Court. On 22nd October, 1980 on the application of the Appellant the Board of Review stated a case pursuant to Section 69, setting out at the end thereof the questions of law for the opinion of the High Court (being the issues hereinbefore mentioned).

p.7

p.21 l1.12-31

(iv) There is provision for an appeal to go direct to the Court of Appeal rather than the High Court; that provision applied in the present case. Consequently on 13th July, 1983 the Court of Appeal (Leonard V.P., Cons. J.A. and Barker J.A.) dismissed the Appellant's appeal with costs. p.33

(v) On 29th July, 1983 the Court of Appeal gave the Appellant conditional leave to appeal to the Privy Council. Final Leave was given on 13th December 1983. p.36

4. Section 69(2) of the Ordinance provides that the Stated Case "shall set forth the facts and the decision of the Board". The Appellant may be under some difficulty, in that the facts are not at first sight set forth in the Case Stated. Nevertheless, the following facts can be gathered from the Case Stated, etc., and are sufficient to dispose of the present appeal.

(i) The Appellant was incorporated in Hong Kong on 10th March, 1970 as a company limited by guarantee and not having a share capital. Its main object, which was in fact carried out, was to acquire and hold premises constituting a stock exchange, and generally to do all things appropriate to the running of a stock exchange.

(ii) The Appellant opened its premises to members for their business on 5th January, 1972, and consequently became liable to profits tax (assuming that the conditions of liability existed) for the year of assessment 1971/1972, which ended on 31st March, 1972.

(iii) By the Articles of Association of the Appellant the management and control of the stock exchange was in the hands of a committee, which consisted of the 14 founder members (who made contributions towards establishment of the stock exchange), and 10 other members elected by the general membership. Members were elected by the said committee. On his election each new member was required to pay an entrance fee of $20,000, that being the figure decided by the committee under the Articles. In addition, every member had to pay a subscription which did not exceed $500 a month, again the amount being decided by the committee. Non-payment of dues rendered a member liable to expulsion and the committee had disciplinary powers should there be a breach of the Exchange Rules, or conduct "injurious to the character or interests or prejudicial to the objects of the Exchange". p.43

(iv) Neither founders' contributions nor entrance fees are allowable deductions for the purposes of Section 16. But subscriptions are such allowable deductions.

(v) Persons who joined the Appellant did so with the object of personal, financial gain. The primary object of the Appellant was the financial benefit of its members.

(vi) The members were stockbrokers, who belonged to the Appellant and made use of its premises and their membership for the purposes of carrying on business as stock-brokers; that business, apart from the occasional giving of advice, was contained in the buying and selling of shares.

5. It is submitted that, on each of the three questions of law that are raised at the end of the Case Stated, both the Board of Review and the Court of Appeal came to the correct conclusion.

p.21 ll.11-31

(i) The first question considered by the Court of Appeal was whether, on a proper construction of the provisions of Section 24(1), having regard to the evidence adduced before the Board of Review, the Appellant was carrying on a "club or similar institution". The Board of Review found that the Appellant had not discharged the onus of establishing exemption on the ground that it was a "club or similar institution". The Court of Appeal answered the question put to it in the negative. The Appellant thus failed on this ground. The following points are significant:

p.18 ll.35-40

p.33 ll.27-30

(a) The word "club" is not defined in the Ordinance.

(b) The word "club" carries the connotation of social intercourse. That is clear from the definition in the Oxford English Dictionary.

(c) Section 24, particularly sub-section (3), indicates, by its juxtaposition of "club" and "trade association" that the two concepts are mutually exclusive. The Stock Exchange being, it is submitted, a trade association, cannot be a club within the statutory meaning.

(d) An essential characteristic of a club is that the persons who are members thereof associate not for the purposes of trade,

but for social reasons, or the pursuit of some common (not trading) activity. It is submitted that the extract from the judgment of Dixon J. in the Australian case Bennett v. Cooper 1948 76 CLR 570, 580, is correct, particularly as it rules out an association having gain as its purpose. p.25 11.9-36

(e) The reference to "similar institution" merely brings into the same classification as "club" the kind of voluntary association that, perhaps, has no premises and might hesitate to dignify itself by the appellation "club"; examples are, perhaps, an old comrades' association, a ramblers' association, or a fellowship formed for a particular sport or other pursuit. They are perhaps too loose in their organisation, and infrequent in their meetings, to qualify as a club, but they have the necessary similarity, in that they are not formed for the pursuit of gain.

(ii) It is submitted that the Appellant is a person who "carries on a trade association". An association clearly includes a body corporate, particularly one limited by guarantee. Stockbroking is a trade. It cannot be erroneous in law to describe running a stock exchange as carrying on a trade association. As an alternative it is submitted that, when the Board found that the members of the Appellant carried on trade, they were making a finding of fact; there is no appeal from that finding unless the Appellant can demonstrate that it contradicts the true and only conclusion from the evidence; and that the Appellant cannot demonstrate.

(iii) In order to be caught by Section 24(2) the Appellant must carry on its 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...". As appears from the Case Stated, founders' contributions and entrance fees are not such allowable deductions. In the period under review, the Appellant's accounts showed the following receipts:

Members' monthly subscriptions.....	$ 130,660	p.7,l.24-p.8,l.6
Founders' contributions.....	$ 350,000	
Members' contributions by way of entrance fees.....	$5,745,000	

It is submitted that only the "members' monthly subscriptions $130,660" qualify as "receipts by way

of subscriptions"; and it being common ground that they are allowable deductions (while the founders' contributions and entrance fees are not), it follows that all the receipts of the Appellant by way of subscriptions qualify under Section 24(2), so that the Appellant (even if it does not otherwise "carry on a business") is deemed to carry on a business, so as to be chargeable to profits tax. Both the Board of Review and the Court of Appeal decided, correctly, that the words "receipts by way of subscriptions" excluded the founders' contributions and entrance fees. Section 24(2) itself uses the phrase "(including entrance fees and subscriptions)", thus making it clear that there is a distinction between an entrance fee and a subscription. That distinction accords with normal experience and with commonsense. Any Court may take notice of the fact that to join an association often requires an entrance fee, while to remain a member often requires a subscription.

6. It is submitted, therefore, that the Board of Review were not in error in arriving at the conclusion that the Appellant did not carry on a club or similar institution, did carry on a trade association, and did obtain "more than half its receipts by way of subscriptions" from persons who could treat those subscriptions as allowable deductions. Consequently, the concluding words of Section 24(2) apply, the Appellant is deemed to carry on a business (whether or not in fact it did carry on a business) and the whole of its income including all entrance fees and subscriptions are deemed to be receipts from business, in respect of the profits from which the Appellant is chargeable to profits tax.

7. It is respectfully submitted therefore that this appeal should be dismissed with costs for the following among other

R E A S O N S

1. BECAUSE on a proper construction of Section 24 of the Inland Revenue Ordinance the Appellant did not carry on a club or similar institution during the year of assessment 1971/1972.

2. BECAUSE on a proper construction of Section 24 of the said Ordinance the Appellant carried on a trade association during the year of assessment 1971/1972.

3. BECAUSE the words "receipts by way of subscriptions" in Section 24(2) of the said Ordinance exclude the sums paid to the Appellant by its members by way of founders' contributions and entrance fees.

4. BECAUSE the Appellant was chargeable under Section 24(2) of the said Ordinance with profits tax for the year of assessment 1971/1972 in respect of the profits from founders' contributions and entrance fees and subscriptions paid to it by its members.

5. BECAUSE the Appellant cannot demonstrate that the Board of Review made any error of law in arriving at their decision.

6. BECAUSE the Court of Appeal came to the correct conclusions for the correct reasons.

D. C. POTTER Q.C.

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- and -

COMMISSIONER OF INLAND REVENUE — Respondent

CASE FOR THE RESPONDENT

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