Privy Council Appeal No. 9 of 1977

Commissioner of Inland Revenue - - - - - *Appellant*

v.

Far East Exchange Limited - - - - - - *Respondent*

FROM

THE COURT OF APPEAL OF HONG KONG

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 31ST JANUARY 1979

Present at the Hearing:

LORD DIPLOCK

VISCOUNT DILHORNE

LORD RUSSELL OF KILLOWEN

[*Delivered by* LORD RUSSELL OF KILLOWEN]

This appeal from the Court of Appeal of Hong Kong concerns the question whether the appellant Commissioner was correct in contending that the respondent Company (" the Company ") should for the year of assessment 1971/72 be additionally assessed for profits tax in the sum of HK$4,880,000, that sum being the total of entrance fees charged in the relevant period to persons admitted as members of the Stock Exchange organised by the Company, which fees had not been included in the Company's relevant return for the purposes of profits tax under the Hong Kong Inland Revenue Ordinance. The Company appealed to the Board of Review against the additional assessment, and its appeal was allowed and the additional assessment annulled. At the request of the Commissioner the Board stated a case for the opinion of the Court of Appeal. The Court of Appeal upheld the decision of the Board of Review, and the Commissioner now appeals to their Lordships' Board.

The appeal depends upon the construction of the Ordinance as applied to the facts of the case.

The Company is one limited by guarantee. It was formed for the purpose of providing for its members premises and facilities for the conduct of a Stock Exchange, and that it did and does. By its Articles of Association the membership is limited to 150. The election of members is in the hands of a Committee. On election a person before actually becoming a member must pay to the Company an entrance fee and the subscription for the current month. The amount of the entrance fee and of the monthly subscription is fixed from time to time by the Committee. There is power in the Committee to expel a member for improper conduct or failing to pay what he may owe to the Company.

The Articles dealing with subscriptions and entrance fees and rights to seats in the Exchange are 9, 11, and 13 to 20 inclusive.
These are as follows:—

"9. The Subscription to the Exchange shall be such sum as the Committee may from time to time determine to be paid monthly in advance on the first day of each month. A member elected after the first day in any month shall not be liable to pay his monthly subscription for any month prior to the one in which his election takes place. The subscription shall continue to be payable notwithstanding any absence of a member from the Colony.

"11. The entrance fee of the Exchange shall be decided by the Committee. Entrance Fee will be deemed to be capital receipts and under no circumstances will Entrance Fee be refundable.

"13. All seats in the Exchange shall belong to the Exchange, but every member shall be entitled to the benefit of a seat to be allocated by the Committee. Upon expulsion of any member, the seat and all benefits appertaining thereto shall revert to the Exchange and the expelled member shall have no claim thereon, but nevertheless, remain liable for all moneys which shall be due from him to the Exchange and Member Creditors.

"14. No member, other than the right of disposal upon resignation, shall assign any rights, benefits or privileges of membership or create any pledge, hypothecation or lien thereon or therein, and no notice of any assignment, pledge, hypothecation or lien shall be effective as regards the Exchange for any purpose, nor shall any interest be recognised by the Exchange save as in these Articles are specifically mentioned.

"15. Any member, unless under suspension, may give one calendar month's notice in writing of his desire to resign his membership. At the expiration of such notice, the member giving such notice shall cease to be a member and a vacancy in the membership shall occur, unless within that period he has withdrawn in writing his notice of resignation. A notice of resignation given by a member called upon to resign by the Committee shall not be withdrawn.

"16. Any member who has given notice of resignation may from the date thereof until such notice expires nominate or cause to be nominated and put up for election as a member such person desirous of becoming a member to fill the vacancy. The nominee will be considered and balloted for membership in the same way as any other candidate but if approved by the Committee for membership, the nominee will not be required to pay any Entrance Fee.

"17. On the death or bankruptcy of any member his membership shall cease and a vacancy in the membership shall occur. Upon any vacancy in the membership occurring through the death or bankruptcy of any member, the personal representative or the trustee in bankruptcy of such member as the case may be may within the period of twelve calendar months, to be computed from the date of the death or adjudication of such member as the case may be nominate or cause to be nominated and put up for election such person who is desirous of becoming a member to fill the vacancy. The nominee will be considered and balloted for membership in the same way as any other candidate but if approved by the Committee for membership, the nominee will not be required to pay any Entrance Fee.

" 18. In the event of any person being nominated by or through a resigning member, personal representative or trustee in bankruptcy of a member, as the case may be, and being put up for election and duly elected, the amount agreed to be and paid by such newly elected member shall be paid to the Exchange, and shall, subject to the deduction of any moneys owing by such resigning, deceased or bankrupt member to the Exchange or to any member creditor of his, be paid to such resigning member, personal representative or trustee in bankruptcy as the case may be.

" 19. If any member is expelled from membership of the Exchange, there shall become a vacancy in the membership.

" 20. Upon the expiration of any notice of resignation of any member or if no nomination of any candidate for election shall have been received within the stipulated time by or through the resigning member, his personal representative or trustee in bankruptcy, as the case may be, as hereinbefore provided, there shall be deemed to be a vacancy in the membership. The Committee of the Exchange may fill up such vacancy by the election of any person as a member and pay any moneys received by the Committee from such newly elected member to such resigning member, his personal representative or trustee in bankruptcy, as the case may be, subject to the deduction of any moneys owing to the Exchange or to any member creditor by such resigning, deceased or bankrupt member ".

It will be seen from these Articles that where a member ceases to be such by resignation, or death, or bankruptcy, he or his estate or his trustee in bankruptcy has a right to nominate a person for membership, subject to the Committee finding the nominee suitable for election. That nominee is not required to pay an entrance fee to the Company and will ordinarily (in lieu) have agreed to pay an appropriate bargained sum to the retired member (or his estate or trustee in bankruptcy) if and when elected in exchange for the nomination. If there be no nomination the Committee may elect someone in place of the former member: and if that is done the person elected must pay to the Company the current entrance fee, but the Company must pass it on to the former member, or his estate, or his trustee in bankruptcy.

Accordingly the position is that the Company is limited in the number of entrance fees that it can receive and retain to 150 plus any occasion of the expulsion of a member, unless of course the Articles of Association were to be amended by increasing the ceiling of 150.

Against that factual background their Lordships turn to the crucial provisions of the Ordinance, namely s.14 and s.24(2). These are as follows:—

" 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 ".

" 24.(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 ".

The principal argument for the Commissioner rested upon the express language of s.24(2). It was common ground that thereunder the Company was a person deemed to carry on a business, and it was contended that accordingly these entrance fees were to be deemed to be receipts from business, so that they were to be included in the assessment of profits of the business for the purposes of s.14.

The primary answer for the Company relied upon the parenthesis in s.14, asserting that the entrance fees in this case were " profits arising from the sale of capital assets ".

The Board of Review while noting this contention by the Commissioner were content to decide the case on the basis that in their view the entrance fees were capital in nature rather than income, and did not rely upon the parenthesis. In the Court of Appeal the answer to the third question posed by the Board of Review quite plainly proceeds upon the view that, but for the parenthesis in s.14, the additional assessment would have been correctly raised: though in the body of the judgments of Leonard J. and McMullin J. (with which Briggs C.J. agreed) they appear to have relied also on the view that the entrance fees being capital in nature they escaped assessment.

Their Lordships consider first the Company's reliance upon the parenthesis in s.14. In their Lordships' opinion the entrance fees cannot be regarded as " profits arising from the sale of capital assets ". Acceptance into the benefits of membership on payment of the entrance fee was not a sale at all: it was a grant for value of a right to those benefits, to the bundle of rights involved in membership: the capital assets referred to in the parenthesis must be assets of the Company, but the rights involved in membership were never among the assets of the Company. They could not figure in the balance sheet of the Company as an asset: the actual physical " seats " would figure as such assets and would continue to do so after allocation to the use of members. Leonard J. referred to the transaction as " in effect " selling a capital asset. McMullin J. applied the word " metaphorical ". Their Lordships recall the comments of Viscount Radcliffe on the question whether to impart know-how for a consideration was a sale of a fixed asset, when he said that know-how was a fixed asset "only . . . by metaphor ". (*Musker v. English Electric Co. Ltd.* (1964) 41 T.C. 556.) In truth the transactions in question resemble that which takes place when a company limited by shares issues for subscription some of its unissued share capital, which plainly does not involve the sale of an asset: though by that comment their Lordships do not, as will appear, intend to indicate that the receipts of entrance fees are necessarily receipts capital in nature.

The Company however did not rely only upon the s.14 parenthesis. It was contended that the word " income " in s.24(2) meant income as distinct from " capital ": that these particular entrance fees were capital in nature: and consequently they were not by the section deemed to be receipts from the deemed business for the purposes of s.24(2). Their Lordships, in agreement with the Court of Appeal, read " income " as having no such special interpretation: they consider that it means no more than receipts from transactions, and accordingly reject that contention for the Company.

Finally for the Company it was contended that even so the real charging section was s.14: that s.14 on a view of the legislation as a whole was not to be construed as applicable to profits of a capital nature: that the entrance fees were of that latter character: and therefore they were not brought into charge for profits tax.

Their Lordships do not propose to decide whether these entrance fees were capital or income in nature: nor do they propose to decide whether s.14 divorced from s.24(2) is to be so restricted. The facts remain

(1) that s.24(2) deems the Company to have been carrying on business

(2) that s.24(2) deems the entrance fees to be receipts from business and provides that the Company shall be chargeable in respect of the profits from the business and

(3) s.14 opens with the words "subject to the provisions of this Ordinance".

In their Lordships' opinion the result of this must be, on any footing, that the entrance fees are to be brought into the computation of the profits of the Company for the purposes of profit tax.

The questions of law posed by the Board of Review were as follows :—

"(i) 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?

"(ii) 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?

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

These questions were based on the limited approach of the Board to the problem, as above stated. As appears from this Opinion the first question should be answered in the affirmative: the second and third questions do not arise for decision.

Their Lordships will humbly advise Her Majesty that the appeal should be allowed with costs here and below, and that the case be remitted to the Board of Review with directions to uphold the additional assessment.

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In the Privy Council

COMMISSIONER OF INLAND REVENUE

v.

FAR EAST EXCHANGE LIMITED

DELIVERED BY
LORD RUSSELL OF KILLOWEN

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