

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D51/88

Profits tax - insurance company (non-life) - interest received from offshore deposits - whether subject to profits tax - s 23A of the Inland Revenue Ordinance.

Profit tax - insurance company (non-life) - treatment of profits derived from non-insurance business - whether interest derived by an insurance company is derived from its insurance business - s 23A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Patricia J Loseby and Michael A Olesnicky.

Date of hearing: 27 September 1988.

Date of decision: 1 December 1988.

The taxpayer companies carried on non-life insurance business and were therefore assessable to profits tax pursuant to section 23A of the Inland Revenue Ordinance. In the course of their business, they placed funds on deposit offshore and received interest thereon.

The taxpayer claimed that such interest did not 'arise in or derive from Hong Kong' within the meaning of section 23A. The IRD conceded that, under the so-called 'provision of credit test', the interest would normally be treated as falling outside this provision. However, the IRD argued that the deeming provisions of section 15(1)(f) applied to section 23A so that, under the wording of section 15(1)(f) as it was then worded, such interest should be deemed to have a Hong Kong source notwithstanding the fact that the funds were deposited offshore.

Held:

The interest was not taxable.

- (a) Section 23A exclusively deals with the taxation of non-life insurance companies, and is not subject to other provisions of the Inland Revenue Ordinance.
- (b) Where a non-life insurance company carries on both insurance and non-insurance businesses, the profits from the latter are assessed according to the normal profits tax assessment provisions of the Inland Revenue Ordinance.
- (c) However, the interest income of an insurance company is derived from its insurance business, so that it can be taxed only pursuant to section 23A.

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[Editor's note: This case concerned section 15(1)(f) as it existed prior to its amendment in 1986.]

Appeal allowed.

Luk Nai Man for the Commissioner of Inland Revenue.  
Denis O'Dwyer for the taxpayer.

Decision:

This decision relates to two separate appeals by two associated companies carrying on insurance business other than life insurance business. One appeal was against assessments to additional profits tax for the year of assessment 1984/85 and profits tax for 1985/86. The other was in relation to profits tax for the year 1986/87. Though two separate Taxpayers were involved in separate appeals, the two appeals were heard together, the two Taxpayers were represented by the same person, and the material facts and circumstances were identical. Accordingly, it is appropriate for us to issue one decision only covering both appeals. As the relevant facts are identical in both cases, it is convenient to set them out once only as follows:

1. The Taxpayers are companies incorporated in Hong Kong carrying on in Hong Kong insurance business other than life insurance business.
2. Each Taxpayer earned interest on moneys which were placed on deposit outside Hong Kong, and which we refer to as 'offshore interest income'.
3. Each of the Taxpayers when filing their relevant tax returns claimed that the offshore interest income was not subject to Hong Kong profits tax because it did not arise in nor was it derived from Hong Kong. The Commissioner in his decision held that the interest income though earned on moneys outside of Hong Kong was in each case taxable and he gave as his reasons therefor in each case the following:
  - '(1) Section 14 of the Inland Revenue Ordinance is the general charging provision and provides that profits tax shall be charged on every person carrying on a trade profession or business in respect of assessable profits arising in or derived from Hong Kong. Section 15 deems certain sums to be receipts arising in or derived from Hong Kong from a trade, profession of business carried on in Hong Kong. Section 23A prescribes the basis for ascertaining the assessable profits of a corporation from the business of insurance other than life insurance.

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- (2) At the relevant times, section 15(1)(f) so far as relevant deemed to be receipts arising from Hong Kong from a business carried on in Hong Kong -

"Sums received by or accrued to a corporation by way of interest arising through or from the carrying on by the corporation of its business in Hong Kong, notwithstanding that the moneys in respect of which the interest is received or accrued are made available outside Hong Kong."

- (3) The Company claims that the offshore interest income in question is not assessable because it is not interest arising in or derived from Hong Kong and section 15(1)(f) has no application in computing the assessable profits of a non-life insurance company. As I understand it, the Company's argument is that section 15 is merely a deeming section which supplements section 14. As section 14 is subject to and overridden by section 23A, then similarly section 15, in particular section 15(1)(f), is also subject to and overridden by section 23A.
- (4) I cannot agree with the Company's contention. In my view, section 15 is a general deeming section which has effect over all the provisions of the Ordinance under Part IV profits tax. In fact the opening words of the section are "For the purposes of this Ordinance". As section 15 is to be read in conjunction with section 14, then section 23A which supplements section 14 should also be read in conjunction with section 15. Therefore section 15 should also have effect in cases where section 23A is applied.
- (5) I have noted that in argument the Company has relied on the Hong Kong tax case of CIR v Far East Exchange Limited (1979) 1 HKTC 1036. However, I do not think that case does any more than say that section 14 is subject to the other specific provisions of the Ordinance. It is no authority for contending that section 15 is merely an extension of section 14 and has no application to other sections of the Ordinance under Part IV profits tax.
- (6) I have therefore concluded that the interest income in question is deemed under section 15(1)(f) as arising in or derived from Hong Kong irrespective of the location where the moneys were held or deposited and is properly chargeable to tax under section 23A.'

The Taxpayer in each case appealed against this determination of the Commissioner.

At the hearing of the appeal, it was common ground between the parties that the provision of credit test applied in this case so that the offshore interest income would not be taxable because it did not

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arise in nor was it derived from Hong Kong other than for the wording of section 15(1)(f) of the Inland Revenue Ordinance ('the Ordinance') as it then appeared. It was accepted or conceded by the Revenue that, except for the amended wording of section 15(1)(f) as it appeared at that time, this offshore interest would not have been taxable in Hong Kong. Accordingly, it was not appropriate for this Board to consider whether or not any other tests should apply for determining the taxability of this interest.

The representative for the Taxpayers addressed us with regard to the principles which should be applied relating to the interpretation of statutes. He then referred us to the general scheme of Part IV of the Ordinance and submitted that, if the Legislature makes specific provisions for particular persons or events, then such provisions should be considered to be comprehensive. He said that in such circumstances it should not be necessary to look elsewhere in the Ordinance.

After referring in detail to the Commissioner's determination, the Taxpayers' representative went on to argue that, if section 23A did not stand on its own in relation to insurance companies, then there would be double taxation. He submitted that the Commissioner's determination would mean that double taxation would occur. He submitted that section 15(1)(f) could have no application in cases where section 23A applied.

The representative for the Commissioner submitted that section 15(1)(f) of the Ordinance applied to the present case. He pointed out that it was agreed by the Taxpayers that, if section 15(1)(f) applied, then this interest would be taxed because it would be deemed to be a Hong Kong business receipt.

He supported the view of the Commissioner which was that section 15 is a general deeming section which has effect over all the provisions of the Ordinance. He pointed out that the opening words of section 15 are 'For the purposes of this Ordinance'. He said that, as section 15 is to be read in conjunction with section 14, section 23A which supplements section 14 should also be read in conjunction with section 15. He submitted that therefore section 15 should also have effect in cases where section 23A applied.

The Commissioner's representative also made submissions with regard to the rules of statutory interpretation and went through the framework of Part IV of the Ordinance.

He referred to the history of the 1984 amendment of section 15(1)(f) and the reasons behind the amendment. He said that, rightly or wrongly, the Commissioner has taken the view and accepted that the 'provision of credit test' is the method of deciding the source of interest income. This test had precluded the assessment of interest derived from deposits or loans placed overseas because such interest was considered to be derived outside of Hong Kong. Many corporations and businessmen had taken advantage of the Commissioner's view and had placed their funds on deposit overseas. It followed that the yield of tax from interest was much diminished. The seriousness of the problem had grown

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over the years and finally, in 1984, the Financial Secretary saw fit to introduce amendments to the then wording of section 15(1)(f). The representative said that the intention of the Financial Secretary in amending section 15(1)(f) was to displace the 'provision of credit test' in determining the source of interest where moneys were loaned or deposited as part and parcel of the operations of a business carried on in Hong Kong.

The Commissioner's representative said that it was important to note that the 'provision of credit test' problem existed both in section 15(1)(f) and section 23A. He said that the amendment to section 15(1)(f) was meant to affect all corporations carrying on a trade or business in Hong Kong and pointed out that, in his speech, the Financial Secretary mentioned no exceptions. He submitted that the reason why the wording of section 23A had not been amended was because the Legislature had considered that section 23A was subject to the provisions of section 15(1)(f).

We have carefully reviewed the submissions made on behalf of the two Taxpayers and the Commissioner. We would like to place on record our appreciation to both of the representatives for having provided us with full copies of their submissions and copies of their supporting authorities. By so doing they have reinforced their verbal submissions by giving us the opportunity of studying in detail what they said to us. This is a procedure which we commend to those who appear before the Board of Review in the future.

We have come to the decision that section 23A applies in these cases to the exclusion of section 15(1)(f) and that therefore the Taxpayers' appeals are successful.

We reach this decision upon the wording of section 23A which appears to us to be quite clear as to its meaning. The first words of section 23A read as follows:

'The assessable profits of a corporation, whether mutual or proprietary, from the business of insurance other than life insurance, shall be ascertained by taking the gross premiums from such insurance business in Hong Kong less any such premiums returned to the insured and any premiums paid on corresponding reinsurance and adding thereto any interest or other income arising in or derived from Hong Kong and the amount of any balancing charge directed to be made under Part VI, and deducting therefrom ...'

This wording is quite clear and is mandatory. It is likewise all-encompassing. We agree with the Commissioner's representative that section 23A does not cover all businesses which an insurance corporation may conduct. A corporation may (if permitted by law) carry on insurance business and other business. The other business would not come within section 23A and would fall to be assessed in the usual way by applying section 15. However, the interest income in this case is not a separate business, but is 'part and parcel' of the business of insurance. It is

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well recognised that insurance businesses derive a substantial part of their income from the investment of surplus funds which derive from and form part of the insurance business.

We find it significant that section 23A sets out in detail all of the items which are to be included as income of a person carrying on insurance business other than life insurance. The wording of section 23A leaves no room to introduce other words from the Ordinance. Section 23A expressly includes any interest arising in or derived from Hong Kong. When the Legislature at the request of the Financial Secretary amended section 15(1)(f) to abrogate the provision of credit test, no such amendment was made to section 23A. The Commissioner's representative has asked us to accept that section 23A was not amended because section 15(1)(f) applied to it. On the other hand, it may be that section 23A was not amended because insurance companies were considered to be in a different category from other companies. Or perhaps a mistake was made.

Whatever the reasons may have been, the fact is that section 23A stands alone and it was not amended. If the Legislature wanted to make insurance companies taxable on offshore interest, then the words 'interest or other income arising in or derived from Hong Kong' appearing in section 23A should have been amended. They were not and accordingly we allow this appeal and find in favour of the two Taxpayers.

We direct that the assessments appealed against by the two Taxpayers be now remitted back to the Commissioner to reduce the assessments by deduction of the offshore interest income from the taxable profits.