Case No. D14/89

Profits Tax – interest income – whether offshore interest taxable under section 15(1)(g) of Inland Revenue Ordinance as amended by Inland Revenue (Amendment) Ordinance (No 36 of 1984).

Panel: Henry Littion QC (chairman), Chen Yuan Chu and Stephen Lau Man Lung.

Dates of hearing: 3 and 4 May 1989.
Date of decision: 31 May 1989.

The taxpayers were a firm of solicitors carrying on business in Hong Kong. They earned offshore interest on a London US$ account on the firm's circulating capital. During the period in question, section 15(1)(g) of the Inland Revenue Ordinance had been amended by the Inland Revenue (Amendment) Ordinance (Number 36 of 1984). It was argued by the taxpayers that under the wording of the amendment to the Inland Revenue Ordinance, there was a distinction between corporations and unincorporated businesses. It was argued by the taxpayers that to be taxable the interest must be exempt from interest tax under Part V of the Inland Revenue Ordinance.

Held:

The offshore interest was taxable within the amended provisions of section 15(1)(g). The words 'and is exempt from interest tax under Part V' should not be given the restrictive interpretation proposed by the taxpayers.

Appeal dismissed.

Jennifer Chan for the Commissioner of Inland Revenue.
Bill Ahern of Messrs Deacons for the taxpayers.

Decision:

Introduction

1. The Taxpayers are a firm of solicitors. In respect of the two years of assessment in question (1984/85 and 1985/86) the Taxpayers received interest income as follows:

For the basis period ending 31 December 1984	$458,508
For the basis period ending 31 December 1985	$588,226

As to the 1984 interest income the breakdown is as follows:

	$
Accrued from a London US$ account:	440,652
Accrued from a Hong Kong US$ account:	17,856
	458,508

As to the 1985 interest income, the breakdown is as follows:

	$
Accrued from a London US$ account:	569,251
Accrued from a Hong Kong US$ account:	18,975
	588,226

2. The Taxpayers concede that the interest came from the firm's circulating capital and that accordingly the '1984 on-shore interest' amounting to $17,856 and the '1985 on-shore interest' amounting to $18,975 come within the charge to profits tax under section 14 of the Inland Revenue Ordinance.

3. The question on this appeal is whether the '1984 off-shore interest' amounting to $440,652 and the '1985 off-shore interest' amounting to $569,241 are chargeable to profits tax. The assessor came to the conclusion that, having regard to the provisions of section 15(l)(g) of the Inland Revenue Ordinance, the Taxpayers were chargeable in respect of the off-shore interest and the assessment was confirmed by the Commissioner's determination. It is against this assessment as confirmed that the Taxpayers now appeal.

Interest Income: Chargeability

4. This appeal is concerned with the chargeability of off-shore interest: that is to say, interest paid to persons carrying on a profession in Hong Kong in respect of deposits made by them with financial institutions outside of Hong Kong. The interest fell within the period when the law was amended by Inland Revenue (Amendment) Ordinance No 36 of 1984; we are told that this case is the first of its kind to reach the Board of Review on the legal effect of those amendments.

Pre-1984 Position

5. Prior to the amendments introduced by the Inland Revenue (Amendment) Ordinance No 36 of 1984, the position was relatively-straightforward: the charge to interest tax imposed by section 28(l)(a) was in respect of 'interest arising in or derived from Hong Kong on any loan, advance or other indebtedness ...' The Inland Revenue Department has always taken the view that for the purpose of determining whether interest arose in or was derived from Hong Kong, it was the 'originating cause' which determined the source; that is, the place where the credit to the borrower was provided. Thus, where a US$ deposit was made with a financial institution in London, then the interest earned on that deposit did not come within the charge to interest tax under section 28(l)(a) because the credit was provided outside of Hong Kong. Nor would such off-shore interest have come within the scope of section 14 to attract profits tax, because the Inland Revenue Department applied essentially the same test to consider the source of the profit: as the credit was provided outside Hong Kong, the interest yielded thereon would not be profits arising in or derived from Hong Kong within the meaning of section 14. As regards the 'deeming provisions' in section 15, the off-shore interest would not have been caught either. That is because section 15(1)(g), prior to the 1984 amendment, only brought within the charge to profits tax sums received by way of interest which were 'derived from the Colony'. Off-shore interest, not being 'derived from the Colony' did not get swept within the net.

6. The question in this case is whether the 1984 amendments have the effect of sweeping the off-shore interest received by the Taxpayers on their London US dollar account within the charge to profits tax.

1984 Amendments

7. Section 15(1)(g) as amended by the Inland Revenue (Amendment) Ordinance (No 36 of 1984) reads as follows:

> '15(1) For the purposes of this Ordinance, the sums described in the following paragraphs shall be deemed to be receipts arising in or derived from the Colony from a trade, profession or business carried on in the Colony –
>
> (g) sums received by or accrued to a person ... by way of interest arising through or from the carrying on by that person of a trade, profession or business in the Colony, which interest is in respect of the funds of the trade, profession or business and is exempt from interest tax under Part V, notwithstanding that the monies in respect of which the interest is received or accrues are made available outside the Colony'.

8. The Taxpayers' representative at the hearing before us submitted that section 15(1)(g) could be analysed as consisting of the following components:

(a) the interest in question must have been received by or accrued to the taxpayer;

(b) the interest must arise through or from the carrying on of the taxpayer's trade profession or business;

(c) the interest must be in respect of the funds of the trade, profession or business; and

(d) the interest must be exempt from interest tax under Part V.

The argument for the Taxpayers is that the off-shore interest in question satisfies each of these components except (d): since there is no express exemption from interest tax referable to an unincorporated firm in the provisos to section 28(1), such as there is in relation to corporations, the off-shore interest has not been swept within the charge to profits tax.

Construction of section 15(1)(g)

9. If the Taxpayers' argument in this case be correct, there would be a curious anomaly in the law introduced by the 1984 amendments. In relation to corporations, off-shore interest received by or accruing to a corporation by way of interest arising through or from the carrying on by the corporation of its business in Hong Kong would come within the charge to profits tax, notwithstanding that the deposits were made outside Hong Kong: this is plain from the wording of section 15(1)(f). And yet, in relation to unincorporated business, identical deposits would be outside the charge to profits tax. We would hesitate to construe the statute to yield such an odd result unless its language so compels. Do the words 'and is exempt from interest tax under Part V' in the amended section 15(1)(g) require the statutory provisions to be construed in this way?

'Exempt from interest tax under Part V'

10. The expression: '... and is exempt from interest tax under Part V' has been in section 15(1)(g) for a very long time. Assume, for example, that a trading firm, prior to 1984, received interest in Hong Kong from a trade debtor on a loan or advance made to the trade debtor, such interest would clearly have attracted interest tax under section 28(1)(a). Was it intended that the same interest be chargeable again to profits tax? The answer would appear to be no: the sum would not be swept within the 'deeming' provisions of section 15(1)(g) because it is not 'exempt from interest tax under Part V'. Construed in this way, the words in quotations could be said to be used in a wide and liberal sense to mean 'not liable to interest tax under Part V' or 'not brought within the charge to interest tax under Part V': hence, the interest earned on trade debts being brought within the charge to interest tax under Part V is not swept within the net regarding profits tax.

11. When section 15(1)(g) was amended in 1984, the legislative intention was plainly to abolish the 'provision of credit' test so that, irrespective of where the deposit was

actually received, interest on money constituting the 'funds of the trade, profession or business' and received by or accrued to a person carrying on a trade, profession or business in Hong Kong would, prima facie, come within the scope of profits tax. It is, perhaps, worth pointing out in parenthesis that, as a matter of legislative history, as long ago as 1976 the Third Inland Revenue Ordinance Review Committee expressed doubts as to the validity of the 'provision of credit' test, pointing out the opportunities for manipulation which it presented: it is a very simple thing for the local branch of a bank to receive a deposit as agent for its overseas branch and remit the money for deposit off-shore.

12. In effecting the amendments to section 15(1)(g) in 1984, the words as hitherto used in the section 'and is exempt from interest tax under Part V' were retained. In essence, what the Taxpayers now argue is that those words must, as they appear in the amended section 15(1)(g), be given a restrictive construction. The off-shore interest can only be swept within section 15(1)(g), it is argued, where the interest is expressly exempted from interest tax under Part V by reference to one of the provisos made under section 28(1) of the Ordinance.

13. We see no reason for such a restrictive interpretation to be given to section 15(1)(g). As plain English words the expression 'and is exempt from interest tax under Part V' is capable of the broader meaning referred to in paragraph 10 above. Moreover, to give to that expression the broad and liberal construction which we favour would avoid the anomaly as referred to in paragraph 9 above.

In both sub-section (f) and (g) of section 15(1) the mechanism used to bring the interest within the profits tax net is the same: that is, by the use of the words: 'notwithstanding that the moneys in respect of which the interest is received or accrues are made available outside the Colony'. The legislative intent is plainly to sweep off-shore interest within the net in respect of both corporations and unincorporated businesses by abolishing the 'provision of credit' test; it is difficult to imagine any other construction that might sensibly be given to the section, having regard to the words quoted above.

We cannot see how it could be right to defeat this legislative intent by giving to the expression 'and is exempt from interest tax under Part V' the meaning contended for by the Taxpayers' representative.

Conclusion

14. In our view, the off-shore interest in question is caught by the provisions of section 15(1)(g) as applicable to the two years of assessment in question. The appeal is accordingly dismissed.