INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D1/88

Profits tax – ship-owner – charter – whether ship-owner was liable to profits tax on freight fees paid by shippers to charterer – s 23B of the Inland Revenue Ordinance.

Panel: Charles A Ching QC (chairman), Benjamin C Kwok and G C Doherty.

Date of hearing: 27 October 1986.
Date of decision: 6 April 1988.

The taxpayer company owned a ship which it chartered to an associated foreign company under a charter not by demise. The Commissioner, purporting to apply s 23B, assessed the taxpayer to profits tax, not on the charter fees derived by it, but on the freight fees which were paid by shippers of cargo to the associated company.

As is usual in such charters, the master of the ship signed bills of lading on behalf of the taxpayer/ship-owner.

Held:

The freight fees were not subject to profits tax.

(a) Freight fees paid by shippers of cargo to a charterer are not earned by the ship-owner.

(b) The ship-owner received the freight fees as agent for the charterer, and was not beneficially entitled to them.

(c) The freight fees earned by the charterer could not be regarded as being 'in respect of … charter hire' within the meaning of s 23B(1).

The issue of whether the taxpayer was subject to profits tax on the charter fees was not argued.

Appeal allowed.

D J Gaskin for the Commissioner of Inland Revenue.
Anthony Brown of Price Waterhouse for the taxpayer.

Decision:

In this appeal the facts were agreed and we heard no evidence. The Taxpayer is a private limited company incorporated in Hong Kong. It has an affiliated company, A Company of Liberia. The ultimate parent company of both is P Company, also a company incorporated in Hong Kong. The Taxpayer purchased a new vessel and immediately let it on charter to its affiliate for ten years. It was a non-demise charter. Charter hire was fixed at US$10,000 per day and although this was varied by agreement on two subsequent occasions the amount of the charter hire was not in any way predicated upon the amount of freight received by the charterer. The vessel was the only one owned by the Taxpayer and was sold in June 1982, since when the Taxpayer has been dormant. The Taxpayer was assessed to profits tax for the year 1982/83 on assessable profits said to have been ascertained by the Commissioner under section 23B(1) of the Inland Revenue Ordinance. It is against the amount of assessable profits found by the Commissioner that the Taxpayer appeals.

Section 23B(1) begins with the words,

'Where a person carries on a business as an owner of ships and either –

(a) the business is normally controlled or managed from within Hong Kong; or

(b) such person is a company incorporated in Hong Kong,

such person shall be deemed to be carrying on that business in Hong Kong and …'

There follows a formula by which the assessable profit is to be ascertained. It was agreed that the Taxpayer fell within the wording of the subsection.

The formula by which the assessable profit is to be ascertained was also agreed. Put shortly, the formula is as follows:

$$\text{Adjusted world profits} \times \frac{\text{HK uplifts}}{\text{World uplifts}}$$

There the agreement ended.

The Commissioner arrived at figures for 'HK uplifts' and 'World uplifts' by taking the amounts received by the Charterer as freight so that the equation became

$$\text{Adjusted world profits} \times \frac{\text{Non-demise HK Charter Hire Income}}{\text{Non-demise overall Charter Hire Income}}$$

We have no doubt that this was wrong. Our reasons follow.

First, charter hire is the money paid by the charterer to the ship-owner. It is not the money paid by a shipper to the charterer. Money paid by a shipper to the charterer is freight which generally, and in this particular case, has nothing to do with the amount of charter hire paid or payable. The Commissioner's formula confuses the two.

Secondly, the Commissioner based his decision upon section 23B(3) which provides that:

> 'For the purposes of this section, a sum receivable by a ship-owner under a charter party other than a bare boat, voyage or time charter under which there is a demise of the ship, shall be taken to be receivable from the carriage of passengers, mails, livestock and goods or in respect of towage.'

Since the charter party in the present case was non-demise, the subsection applies. But what is its effect? The Commissioner took it to be that it permitted him to regard the charterer's receipts or receivables as being those of the ship-owner. That cannot be right. Tax in Hong Kong is not an income tax but we can find nothing in the Ordinance which imposes any form of tax upon cash or kind which has not been received or is not receivable by the Taxpayer. Here the Taxpayer had no right whatsoever to and did not receive any part of the freight. We find that section 23B(3) provides only that for the purposes of section 23B(1) charter hire received or receivable by the Taxpayer is to be substituted for sums received or receivable by the Taxpayer from the carriage of passengers, mails, livestock and goods or in respect of towage.

Thirdly, the Commissioner found support for his view from the fact that in a non-demise charter party the Master or charterer signing a bill of lading usually does so on behalf of the ship-owner. From this he concluded that:

> 'In other words the uplifts or freights, etc can be regarded as sums receivable by a ship-owner, if not beneficially, then in a fiduciary sense.'

Clearly, any sums which may have been received by the Taxpayer by way of freight in the present case would not have been received by it beneficially. The Taxpayer would have received those sums as a conduit and would have been bound to pay them over to the charterer. In any event there was no evidence that the Taxpayer ever received any freight.

Finally, we come to the wording of section 23B(1) itself. As we have said, it refers to 'a person' carrying on a business as an owner of ships and it provides for circumstances in which 'such person' shall be deemed to be carrying on business in Hong Kong. It goes on to provide for the ascertainment of the assessable profits 'from that business' which therefore is clearly the business of the person carrying on the business as an owner of ships. The formula, which we have briefly set out above, is contained in the following words:

> '... the sum bearing the same ratio to the aggregate of the sums receivable ... by such person in respect of ... [various matters] ... and in respect of charter hire other than charter hire attributable to a permanent establishment maintained by such person outside Hong Kong as his total profits ... bear to the aggregate of the total sums receivable by him ... in respect of ... [various matters].'

The Commissioner construed the words 'in respect of' as meaning 'relating to' and went on to hold that there was nothing in the section requiring the ship-owner to carry out the services himself. He concluded this part of his Determination as follows:

> '[The ship-owner] received his income, of course, as a direct, consequence of the contract of charter, but equally that income can be said to relate to or be "in respect of" the carriage of passengers, etc. for without such activity there would be no charter party and no income accruing to the ship-owner.'

The flaw in this is that the Taxpayer's only income was the charter hire and not the freight and that the activities of the charterer for which the charterer took the charter party have nothing to do with the Taxpayer and cannot be used as a basis for quantifying an assessable profit which the Taxpayer never made. There is nothing in the Ordinance which deems the income of the charterer to be that of the Taxpayer.

Mr Anthony Brown, who appeared for the Taxpayer, addressed to us an argument based upon section 26(b) of the Ordinance which states that:

> 'save as otherwise provided no part of the profits or losses of a trade, profession or business carried on by a person who is chargeable to tax under this Part shall be included in ascertaining the profits in respect of which any other person is chargeable to tax under this Part.'

We can make no finding on this since it has not been shown to us that any other person would be chargeable to tax as envisaged in that section.

Nor do we make any comment or finding as to whether or not the Taxpayer would be assessable to profits tax upon the charter hire for this has not been argued before us.

For the reasons given we allow the appeal.