**Case No. D 3/80**

*Board of Review:*

S. V. Gittins, *Chairman*, Alexander S. K. Au, Professor P. G. Willoughby, & David C. S. Wu, *Members*.

**22 May 1980.**

Inland Revenue Ordinance – profits tax assessment – basis for computing profits under s. 18 – whether appellant was a trade association within the meaning of s. 24(2) – meaning of "trade" – meaning of words "club or similar institution" – date of commencement of business – application of s. 18(3) and s. 18(7).

The appellant was a stock exchange incorporated in Hong Kong as a company limited by guarantee and not having a share capital. In 1973 a Notice of Assessment and Demand for Profits Tax for the year of assessment 1971/72 was issued. The appellant lodged an objection on the ground that it "has amended its Articles of Association in that no subscription shall be payable by its members and as such the taxpayer is not a trade association within the meaning of section 24(2) of the Inland Revenue Ordinance". The Commissioner rejected the objection and the appellant appealed to the Board of Review where it relied upon and argued the following ground:-

(i) That the appellant was not and did not carry on a trade association.

(ii) Alternatively if it was a trade association not more than half its receipts by way of subscription were from persons who claimed or were entitled to claim such sums as allowable deductions for the purposes of s. 16 and therefore the deeming provisions of s. 24(2) did not apply.

(iii) Alternatively that the appellant carried on a club or similar institution which received from its members not less than half of its gross receipts on revenue account and is accordingly not assessable to profits tax.

(iv) That the Commissioner applied s. 18 of the Inland Revenue Ordinance wrongly in deciding the date of commencement of business.

**Decision:** Re ground of Appeal:-

(i) The Board found that the appellant was a trade association.

(ii) The Board found that the subscription referred to in s. 24(2) did not include "founders contributions" and "entrance fees" and therefore this ground of appeal failed.

(iii) The Board found that the appellant had not discharged the onus on it of establishing a claim to exemption based on the fact that it is a "club or similar institution". This ground of appeal failed.

(iv) On the facts the Board allowed this ground of appeal and the case was remitted to the Commissioner to revise his assessment.

**Cases referred to:-**

1. C.I.R v. Far East Exchange Ltd., P.C. App. No. 9 of 1977.

2. Barry v. Cordy, (1946) 2 All E.R. 396.

3. Bank of New South Wales v. The Commonwealth, (1948) 76 C.L.R. 1.

4. Mollett v. Robinson (1872) L.R. 7 C.P. 97.

5. C.I.R. v. Wesleyan & General Assurance Society, (1946) 30 T.C. 11.

6. Bohemian Club v. Acting Federal Commissioner of Taxation, (1918) 24 C.I.R. 334.

7. Bennett v. Cooper, (1948) 76 C.L.R. 570.

H. Litton Q.C. for the Appellant.
H. Somerville and G. S. Chadha for the Commissioner of Inland Revenue.

*Reasons:*

1. The Taxpayer was incorporated in Hong Kong in 1970 as a company limited by guarantee and not having a share capital. It opened its exchange premises to members for their business in 1972.

2. As reflected by the Income and Expenditure Account for the period from 23 March 1970 to 31 May 1972 the Taxpayer received the following:-

| | |
|---|---|
| Members' monthly subscriptions …..…….. | $130,660 |
| Bank Interest ……. | 29,755 |
| Sundry Service: Change Name …….. | 22,000 |

Expenses reimbursed from members:-

| | | |
|---|---|---|
| Coffee Bar …….. | $1,782 | |
| Photostatic Service ……..…….. | 352 | |
| Coloured written pen ……. | 188 | |
| Sales Record …….. | 696 | 3,018 |
| | | $185,433 |

3. In addition to the receipts mentioned in paragraph 2 the Taxpayer received the following up to 31 May 1972:-

(i) *Founders' Contributions:*

| | |
|---|---|
| Received on account March 1970-June 1971…….. | $ 30,000 |
| Balance received July 1971-31 March 1972 ……... | 320,000 |
| | $ 350,000 |

(ii) *Members' Entrances Fees:*

| | |
|---|---|
| August 1971-31 March 1972 | $5,595,000 |
| 1 April 1972-31 May 1972 | 150,000 |
| | $5,745,000 |

4. On 6 September 1973 a Notice of Assessment and Demand for Profits Tax for the year of assessment 1971/72 was issued and the assessable profits of $3,085,022 were computed as follows:-

YEAR OF ASSESSMENT 1971/72

Section 18(3)
Basis Period: 5 January 1972-31 March 1972

| | | | |
|---|---|---|---|
| Loss for period ended 31 May 1972 per account submitted …. | | | $ 328,612 |
| *Less:* Uniform, initial purchase ……... | | 959 | |
| Depreciation charged ……. | | 29,676 | 30,635 |
| | | | $ 297,979 |
| *Less:* Founders' Contribution …….. | | 350,000 | |
| Members' Contribution ……. | | 5,745,000 | 6,095,000 |
| | | Profit | $5,797,023 |
| Average Profit for 5 January 1972-31 March 1972 | | | |
| $\frac{87}{158}$ x 5,797,023……..... | | | $3,192,031 |
| *Less:* Depreciation allowance ……. | | | 107,009 |
| | | Assessable Profit | $3,085,022 |
| | | Tax payable | $ 462,753 |

During the hearing it was agreed that the denominator for the calculation of Average Profit for 5 January 1972 to 31 March 1972 should be "148" and not "158" as stated.

5. On 24 September 1973, Messrs. Stephen Law & Co. lodged on behalf of the Taxpayer an objection against the 1971/72 assessment on the ground that the Taxpayer "has amended its Articles of Association in that no subscription shall be payable by its members and as such the Taxpayer is not a trade association within the meaning of section 24(2) of the Inland Revenue Ordinance". In this letter it was also added that all the subscriptions previously paid by members have been or would be refunded.

6. The Taxpayer's objection was rejected by the Commissioner in his Determination and further the Commissioner exercised his discretion under section 18(7) and increased the assessable profits to $5,701,211 with tax payable thereon of $855,181.

7. The Taxpayer appealed to the Board of Review and the grounds of appeal were as follows:-

1. The Return submitted on behalf of the Appellant dated 16 January 1973 for profits tax under Part IV of the Inland Revenue Ordinance for the year in question in the sum of $328,612.23 ought to have been accepted by the assessor and an assessment made accordingly;

2. The assessor erroneously charged the Appellant to profits tax under section 24(2) of the Ordinance in that: -

   *(a)* the Appellant had duly furnished a return of its assessable profits arising in Hong Kong from its business carried on in Hong Kong and the assessor ought in law to have ascertained the tax payable by the Appellant on the basis of such return under section 14 of the Ordinance and not under section 24(2);

   *(b)* the Appellant was not and did not carry on a trade association;

   *(c)* alternatively, if (which is denied) the Appellant was a trade association, not more than half its receipts by way of subscription were from persons who claimed or would have been entitled to claim that such sums were allowable deductions for the purposes of section 16;

   *(d)* alternatively the Appellant carried on a club or similar institution which received from its members not less than half of its gross receipts on revenue account (including entrance fees and subscriptions) and is accordingly not assessable to profits tax.

3. Alternatively, for the purposes of computation of profits under section 24(2) there should have been excluded from the gross receipt the Founders' Contribution and Entrance Fees received by the Appellant from its members;

4. Alternatively, any Founders' Contribution and Entrance Fees received by the Appellant from its members being of a capital nature should not have been brought into account in the computation of its annual profit and loss;

5. The Appellant had, for the year of assessment ending 31 March 1972, no receipts by way of subscription, the amount of subscription payable by members having been determined as nil – hence the provisions of section 24(2) were not applicable.

6. The Commissioner wrongly applied section 18(3) of the Inland Revenue Ordinance by holding that the Appellant had commenced business on 1 July 1971;

7. The Commissioner wrongly exercised his discretion under section 18(7).

8. At the hearing of the appeal the Taxpayer relied upon and argued grounds *2{b)*, 2(c), *2(d)*, 6 and 7. In this connection it was agreed that the decision of the Privy Council in **CIR** v. **Far East Exchange Ltd.**[1] was not applicable as the points taken in this appeal were not canvassed in the former case.

*Ground of Appeal 2(b): That the Taxpayer was not and did not carry on a trade association.*

9. The law applicable to this ground of appeal is section 24(2) of *Cap.* 112 prior to its amendment by Ordinance 40 of 1972 and was as follows:-

> "(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 amending Ordinance added the words "professional or business" between the words "trade" and "association" in line one.

10. For the Taxpayer it was contended that –

*(a)* the word "trade" in its general connotation is more restrictive than the word "business";

*(b)* the "deeming" provisions of section 24(2) create an artificial situation whereby receipts including capital receipts are made liable to profits tax. Hence a narrow meaning should be given to "trade association" and the section should be confined

[1] Privy Council App. No. 9 of 1977.

to associations dealing with "trade and manufacture" and "adventures and concerns in the nature of trade", i.e., with buying and selling; and

*(c)* the Taxpayer's members must be brokers, and a stockbroker is defined in the taxpayer's articles of association as "a person carrying on business in this Colony as a broker in the purchase or sale of stocks, shares ... either solely or in conjunction with other business". As a broker, a member does not carry on a trade. He carries on a business by buying and selling as agent for clients. As broker he does not buy and sell for himself.

11. For the Commissioner it was contended –

*(a)* In section 2 of *Cap.* 112, the definition section, "'trade' includes every trade and manufacture, and every adventure and concern in nature of trade".

*(b)* "Trade" in tax legislation is a word of the widest import and is not restricted to a regular business of buying and selling [see **Barry v. Cordy**[2] per Scott L.J. at 400 and **B.N.S.W. v. The Commonwealth**[3] at 381].

*(c)* *Blackburn's Contract of Sale* defines "broker" thus –

"A broker for sale is a person making it a trade to find purchasers for those who wish to sell, and vendors for those who wish to buy, and to negotiate and superintend the making of the bargain between them."

This definition was adopted by Hannen, J. in **Mollett v. Robinson**[4] and in 8th *Benjamin on Sale* 275.

*(d)* Object 3(6) of the Taxpayer's Memorandum of Association is –

"To maintain high standards of commercial honour and integrity among its members and to promote and maintain just and equable principles of trade and business."

*(e)* The Taxpayer's members carry on a trade, and therefore the Taxpayer is a trade association.

*Conclusions of the Board*

12. The definition of "trade" in section 2 of *Cap.* 112 is very similar to that in the U.K. Income Tax Acts. This word was considered by the Court of Appeal in **Barry v. Cordy**[2] at p. 399 Scott, L.J. adopted the words of Lord Wright in the Bolton Corporation case that

[2] (1946) 2 All E.R. 396.
[3] (1948) 76 C.L.R. 1.
[4] (1872) L.R. 7 C.P. 97.

"trade" in legal usage is a term of the widest scope [see also Dixon, J. in the High Court of Australia in **Bank of New South Wales v. Commonwealth**[3]**,** at 381].

We find that the members of the Taxpayer carry on a trade, and therefore the Taxpayer is a trade association.

This ground of Appeal fails.

*Ground of Appeal 2 (c): That "subscriptions" in section 24(2) covers "founders' contributions" and "entrance fees" as well as "monthly subscriptions".*

13. Section 24(2) provides that where the Taxpayer is a trade association it is only where more than half its receipts by way of subscriptions are allowable deductions under section 16 to the subscribers that the whole of its income (including entrance fees and subscriptions) are deemed to be receipts from business and chargeable in respect of profits therefrom.

14. The Taxpayer's accounts for the period ended 31 May 1972 showed, *inter alia*, the following items of receipts: -

| | |
|---|---|
| Members' monthly subscriptions …… | $ 130,660 |
| Founders' contributions …….. | 350,000 |
| Members' contributions by way of entrance fees ……... | 5,745,000 |

15. Founders' contributions and entrance fees are not deductible under section 16 by the payers thereof, so that if these 2 items are treated as subscriptions, the deeming provisions would not come into effect.

16. It was contended on behalf of the Taxpayer that "subscriptions" include "Founders' contributions" and "Entrance Fees" for the following reasons: -

*(a)* "Subscriptions" is an ordinary English word which in this case means those sums of money subscribed by members towards the attainment of the objects of the Taxpayer. They are "subscriptions" whether they are paid by Founders as "Founders' contributions" towards the establishment of the Exchange, or by members on first joining as "Entrance Fees", or in monthly sums as "monthly subscriptions".

*(b)* Meanings given by the *Shorter Oxford English Dictionary* include the following: -

SUBSCRIBE:

11. To promise ... to pay (a sum of money) ... to or towards a particular object; to undertake to contribute (money) in support of any object.

12. To undertake to contribute money to a fund, to a society, party, etc.

SUBSCRIPTION:

7. The action or an act of subscribing money to a fund or for stock; the raising of a sum for a certain object by collecting contributions from a number of people.

8. A contribution of money for a specified object; the fixed sum promised or required as a periodical contribution by a member of a society etc. to its funds.

*(c)* The name given to a transaction by the parties concerned does not necessarily decide the nature of the transaction. The question always is what is the real character of the payment. **[C.I.R. v. Wesleyan** & **General Assurance Society**[5] at 25.]

17. The points to the contrary raised on behalf of the Commissioner were as follows: -

*(a)* The word "subscriptions" has a variety of meanings. The meaning to be applied must be gathered from the context in which it is used. [7th *Crates on Statute Law* 169-171] In construing a word in a statute regard must be had to the context in which the word is used and the object of the legislature. If necessary its meaning should be limited to one which is consistent with section 24(2) as a whole. *[Craies* at 177]

*(b)* Upon a true construction of section 24(2) the word "subscriptions" is used to denote recurrent payments as distinct from payments of a once and for all character, see also paragraph 8 of the meaning of "subscription" in the *Shorter Oxford English Dictionary* [paragraph 16*(b)* above].

*(c)* Section 24(2) distinguishes between entrance fees and subscriptions. Only payments which could be considered for deduction under section 16 are envisaged in the use of the word "subscriptions". Thus, payments of a capital nature are excluded. Founders' contributions and entrance fees would be payments of a capital nature.

*(d)* The amendment of section 24(2) in 1971 by the deletion of the words 'entrance fees" and from before "subscriptions" where that word appears was made because only subscriptions are deductible and entrance fees are not deductible, being of a capital nature.

*(e)* The Taxpayer's Articles of Association clearly differentiated between "entrance fees", "founders' contributions" and "subscriptions'. These descriptions indicated

[5] (1946) 30 T.C. 11.

their real and intended characters and were not just different labels for payments of the same kind.

*(f)* The special resolution passed by the Taxpayer on 11 September 1973 amended the Articles of Association by abolishing subscriptions. This was only applicable to ordinary subscriptions and not to founders' contributions and entrance fees.

*Conclusion of the Board*

18. We find the arguments on behalf of the Commissioner compelling and we adopt them.

This ground of appeal fails.

*Ground of Appeal 2(d): That the Taxpayer carried on a club or similar institution*

19. This involves section 24(1) of *Cap.* 112, and it is not disputed that if the Taxpayer carries on a club or similar institution, receipts from Founders' contributions and entrance fees will not be brought into charge for profits tax.

20. For the Taxpayer it was contended –

*(a)* That the section is not confined to institutions with social objectives only as otherwise there would be no profits chargeable to tax.

*(b)* The Taxpayer falls within all the requirements of the definition of a club in **Bohemian Club v. Acting Federal Commissioner of Taxation**[6]**,** at 337 –

"a club is a voluntary association of persons who agree to maintain for their common personal benefit, and not for profit, an establishment the expenses of which are to be defrayed by equal contributions of an amount estimated to be sufficient to defray those expenses, and the management of which is entrusted to a committee chosen by themselves."

*(c)* Section 24(1) should be liberally construed in view of the words "club or similar institution".

21. For the Commissioner it was contended that an association of persons whose main purpose is the acquisition of gain cannot be regarded as a club.

*6 Halsbury's Laws of England, 4th edition 201* states: -

"Definition. A club, except a proprietary club or an investment club, may be defined as a society of persons associated together, not for the purposes of trade, but for social reasons, the promotion of politics, sport, art, science or literature, or for any other lawful purpose;

[6] (1918) 24 C.L.R. 334.

but trading activities will not destroy the nature of a club if they are merely incidental to the club's purposes."

*6th Daly's Club Law (6th edition) 1* states: -

"The word 'club' means essentially an association of individuals in a way that involves to some degree the factors of free choice (which connotes a power of exclusion), permanence, corporate identity and the pursuit as a common aim of some joint interest other than the acquisition of gain (or some mutual advantage directly connected with the acquisition of gain, such as those provided by membership of a professional society or trade union). It is the last-named qualification that distinguishes clubs from business or professional partnerships, and from trade unions and the like. Nevertheless, the mere fact that the acquisition of gain may be incidental to the true activities of an association does not appear to prevent the association from having the character of a club."

Dixon, J. in **Bennett v. Cooper**[7] at 580, in the High Court of Australia said: -

"In most attempts to state the characteristics of a club prominence is given (a) to the nature of the objects for which the members are associated in a body, *(b)* to the contribution of members to a common fund to meet the expenses, and (c) to the gain; for that would mean a partnership of trading company. It is not necessary that gain to the institution should be rigidly excluded from its every activity or operation; it is the purpose for which the body is established that must not include the pursuit of gain to the body or its members if it is to be a club. In short the association may be formed for any object that is neither gainful nor unlawful."

*Conclusions of Board*

22. We find that the contentions of the parties are inconclusive.

23. As to the definition in the **Bohemian Club** case[6], relied on by the Taxpayer, it is at least implied that one of the primary purposes of the Taxpayer is the personal profit of its members.

24. On the other hand an investment club is an association formed for the purpose of making profit for its members and yet it is recognized by *Halsbury* as a form of club. A Proprietary club is also recognized by *Halsbury* as a species of club and yet its main purpose is also that of making profit for its proprietor. Moreover such clubs have not been expressly excluded by the legislature from section 24(1).

25. However, the Taxpayer in this appeal does not fit into either the investment or proprietary club classes. Its members do not aim at profit through the activities of the Taxpayer but through their own independent operations as stockbrokers.

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[6] (1918) 24 C.L.R. 334.
[7] (1948) 76 C.L.R. 570.

26. We find that the members of the Taxpayer became members for the main purpose of enabling themselves to carry on business as stockbrokers and thus earn profits. We think that the authorities are ambiguous and uncertain as to whether this disqualifies the Taxpayer from being regarded as a "club or similar institution" under section 24(1).

27. We therefore find that the Taxpayer has not discharged the onus on it of establishing a claim to exemption based on the fact that it is a "club or similar institution". This ground of appeal therefore also fails.

*Grounds of Appeal 6 and 7: That the Taxpayer commenced business on 5 January 1972 and not on 1 July 1971 as determined by the Commissioner*

28. The Commissioner in his Determination on this point stated: -

> "I think the Assessor was wrong to select 5 January 1972 as the date of commencement of business. I consider the Association commenced to carry on business as a trade association when the founders decided to go ahead and collect in full the Founders' Contribution and to solicit and collect the Entrance Fees from its prospective members. From the evidence supplied and in the absence of a precise date, this seems to be around the 1 July and I think it is reasonable to take 1 July 1971 as the date of commencement of its business as a trade association."

29. Matters relied on in support of the Commissioner's Determination included the following: -

*(a)* Between 23 October 1970 and 14 December 1971 the Taxpayer engaged in correspondence with the Collector of Stamp Revenue and the Registrar General concerning stamping concessions and compliance with conditions for recognition as a stock exchange.

*(b)* On 3 December 1971 the Taxpayer undertook to indemnify the Government for any loss due to the failure of members to pay the correct amount of stamp duty.

*(c)* The Taxpayer arranged lectures for its members on the law and practice of stamp duty in about November 1971.

*(d)* The Taxpayer negotiated for premises for the stock exchange, the lease being executed on 16 November 1971.

*(e)* The Taxpayer compiled rules embodying "Board Trading Rules" prior to 28 December 1971.

*(f)* The Taxpayer approached the Chinese University concerning extramural courses for the training of professional brokers in 1971.

*(g)* The Taxpayer commenced to design a central electronic communication system.

30. We also note that the Taxpayer was incorporated on 10 March 1970. From correspondence produced to the Board it was proved that the Taxpayer was authorized to operate a stock exchange on 5 January 1972 and that before that date it could not do so. Furthermore, monthly subscriptions were charged to members from 5 January 1972.

31. We find that the principal object of the Taxpayer was to provide a place where its members could carry on their business.

32. From the facts before us we find that the matters relied on on behalf of the Commissioner were activities preparatory to the commencement of business by the Taxpayer and that the commencement date of business deemed to be carried on by section 24(2) was 5 January 1972.

33. Accordingly this ground of appeal is allowed.

*Quantum of assessable profits*

34. While section 24(2) deems a business to be carried on by a trade association in certain circumstances, the subsection is in our view nevertheless subject to the normal rules governing the commencement of a business. Thus in the absence of a statutory rule imposing an artificial commencement date the normal rule that the date of commencement is a question of fact applies.

35. We have found that the Taxpayer commenced business on 5 January 1972, and applying section 18(3), its profits will be assessed on the basis that the whole of its income (including entrance fees and founders' contributions) during the period from 5 January 1972 to 31 March 1972 shall be deemed to be receipts from business as provided by section 24(2).

36. We are of the opinion that apportionment under section 18(7) does not arise in this case and we hold accordingly.

37. The case is remitted to the Commissioner for the assessment to be revised in accordance with the Board's opinion that the commencement date of the Taxpayer's business is 5 January 1972 and that profits tax shall be assessed on its income in accordance with section 24(2) during the period 5 January 1972 to 31 March 1972.