

Kowloon Stock Exchange Limited

Appellant

v.

Commissioner of Inland Revenue

Respondent

FROM

THE COURT OF APPEAL OF HONG KONG

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE
OF THE PRIVY COUNCIL, DELIVERED THE 2ND OCTOBER 1984

Present at the Hearing:

LORD KEITH OF KINKEL
LORD BRANDON OF OAKBROOK
LORD BRIGHTMAN
LORD TEMPLEMAN
SIR ROBIN COOKE

[Delivered by Lord Brightman]

This appeal from the Court of Appeal of Hong Kong concerns the assessment of profits tax on the appellant, Kowloon Stock Exchange Limited. Three questions are raised by the stated case: whether the appellant is a club; if not, whether it is a trade association; if a trade association, whether entrance fees and so called Founders' contributions are properly to be described as subscriptions.

The appellant was incorporated under the Companies Ordinance on 10th March 1970 as a company limited by guarantee without a share capital. The objects of the appellant are set out in the first seven paragraphs of clause 3 of the Memorandum of Association, the remaining paragraphs being of the nature of powers exercisable in furtherance of those objects. The objects are as follows:-

"(a) To furnish, purchase, take on lease, hire or otherwise acquire, exchange rooms, security market places, meeting places, and other facilities for the convenient transaction of business by stock brokers, share brokers, exchange brokers and brokers in gold and silver and other precious metals, commodities, foreign exchange and money of all kinds and

to obtain licences in that behalf for members where required.

(b) To maintain high standards of commercial honour and integrity among its members and to promote and maintain just and equitable principles of trade and business.

(c) To protect the interests of such brokers, and to promote honourable practices.

(d) To record transactions between such brokers and to furnish reliable quotations of the price of shares and stocks, gold and silver and other precious metals, commodities and foreign exchange and money of all kinds.

(e) To occupy and take up a role with similar organisations and associations in the vital delicate and rapidly changing aspect of the Hong Kong economy the finance of Hong Kong industry and the provision of necessary safeguards of the investors who directly and indirectly entrust their savings to the stock and shares markets.

(f) To act as arbitrators in the settlement of all disputes and differences between member brokers or between member brokers and their clients arising in the course of business and of those between any parties.

(g) To make rules for any of the above purposes and to make and from time to time alter a scale of charges for brokerage in share and other transactions."

The facts are not extensively set out in the stated case and there is little evidence of the activities of the appellant. No doubt the Memorandum of Association generally reflects what the appellant does. There is a finding of fact that the principal object of the appellant is to provide a place where its members can carry on their business.

The Articles of Association of the appellant at the relevant time included the following provisions, stated shortly:-

Article 2 The number of members is limited to 150.

Article 3 Any person who desires to carry on the business of a stock broker, or of a broker as described in the Memorandum of Association, shall subject to there being a vacancy be eligible for membership.

Article 4 A candidate for membership must sign an application form. His name is then submitted to a ballot. Three adverse votes are sufficient to exclude him.

Article 5 On election and payment of the prescribed subscription and entrance fee, the candidate becomes a member of the appellant, and is entitled to the benefit of a seat on the exchange.

Article 9 The subscription payable to the appellant is a sum not exceeding \$500 per month as the committee may from time to time determine.

Article 11 The entrance fee is also to be decided by the committee.

Article 16 A member who has given notice of resignation may nominate another person for election as a member in his place. Such nominee is not required to pay an entrance fee.

Article 17 A similar right is vested in the personal representative of a deceased member.

Article 28 The eight subscribers to the Memorandum and Articles of Association, and six others, are expressed to be "Founders of the [appellant]". Article 28 (wherein "Exchange" means the appellant) then provides as follows:-

"(b) Each of the Founders shall contribute a sum of not exceeding HK\$40,000.00 towards the establishment of the Exchange.

(c) A Founder shall be entitled to nominate a respectable person to be a member of the Exchange and such nominated member shall not be required to pay any entrance fee for his admission. In the absence of and until such nomination, a Founder shall be entitled to a seat in the Exchange.

(d) A Founder is a member of the Exchange and a member of the Committee for life whether the right of nomination above mentioned shall have been exercised. A Founder who has exercised his aforesaid right of nomination shall not be required to pay any further subscriptions.

(e) The Founders shall be entitled to be paid such remuneration as the Committee shall from time to time decide.

(f) A Founder may nominate a successor who shall be entitled to all the benefits of the Founder. Such nomination must be approved by the Committee and it shall not take effect during the life of the Founder."

Article 29 The management and control of the appellant is vested in the committee, which consists of all the Founders and not more than ten other members.

Article 33 The members of the committee are entitled to such remuneration as the committee shall from time to time decide.

Article 47 The committee have power:-

"(b) To make and from time to time alter as they may think fit a scale of charges for brokerage on all transactions for the sale and purchase of stocks, shares, bonds, debentures and other securities and gold and silver and other precious metals, commodities, foreign exchange and money of all kinds."

Article 52 to 63 These Articles deal with general meetings of the appellant. There is to be found a clear implication that every member of the appellant is entitled to vote at a General Meeting.

On 16th November 1971 the appellant took a lease of the premises which it intended to use for its activities. On or before 28th December 1971 the appellant compiled rules embodying "Board Trading Rules". On 5th January 1972 the appellant was authorised to begin operations as a stock exchange, and monthly subscriptions began to be payable.

Part IV of the Inland Revenue Ordinance (1971) contains a number of sections under the cross-heading "Profits Tax". Section 14 is in the following terms:-

"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."

Section 16 of the Ordinance provides that in ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment, there shall be deducted all outgoings and expenses to the extent to which they are incurred in the production of profits, with certain specific inclusions. Section 24, upon which this appeal hinges, is in the following terms:-

"24. (1) Where a person carries on a club or similar institution which receives from its members not less than half of its gross receipts on revenue account (including entrance fees and subscriptions), such person shall be deemed not to carry on a business; but where less than half of its gross

receipts are received from members, the whole of the income from transactions both with members and others (including entrance fees and subscriptions) shall be deemed to be receipts from a business, and such person shall be chargeable in respect of the profits therefrom.

(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.

(3) In this section, "members" means those persons entitled to vote at a general meeting of the club, or similar institutions, or trade association."

In the period which is relevant for the purpose of ~~computing the liability (if any) of the appellant to~~ profits tax, the appellant received the following monies from its members:-

Monthly subscriptions	\$130,660
Other receipts on revenue account	54,773
Total	185,433
Founders' contributions (i.e. at the rate of \$25,000 per Founder)	350,000
Members' entrance fees	\$5,745,000.

It is common ground that the monthly subscriptions of \$130,660 were paid by persons who were entitled to claim that such sums were allowable deductions for the purposes of section 16; also that Founders' contributions and members entrance fees were not allowable deductions. It follows that, in the context of sub-section (1) of section 24, if applicable, the appellant received from its members not less than half of its gross receipts on revenue account, including entrance fees and subscriptions, whatever might be the true status of Founders' contributions; so that, if the association is a club, it would be deemed not to carry on a business; and that, in the context of sub-section (2), if applicable, more than half its receipts by way of subscriptions were allowable deductions, unless Founders' contributions or entrance fees, or both, had the status of "subscriptions"; so that, if a trade association, it would be deemed to carry on a business unless either of these payments were subscriptions.

On 6th September 1973 the appellant was assessed to ~~profits tax on the basis that it was not a club, but~~

was a trade association and that neither Founders' contributions nor entrance fees were subscriptions. The appellant appealed to the Board of Review against the determination of the Commissioner of Inland Revenue. The Board decided that the appellant carried on a trade and was therefore a trade association; and that Founders' contributions and entrance fees were not subscriptions, with the result that sub-section (2) of section 24 applied; and that the appellant had not established a claim to exemption based on the fact that it was a "club or similar institution" within the meaning of sub-section (1).

On 22nd October 1980 the Board of Review stated the following questions of law for the opinion of the High Court, but with leave under section 69A of the Ordinance (1981) the appellant appealed directly to the Court of Appeal against the Board's decision:-

- (i) Whether, on a proper construction of the provisions of the section 24(2), having regard to the evidence adduced before the Board of Review, the Appellant could be said to have been carrying on a trade association;
- (ii) Whether the words 'receipts by way of subscriptions' in section 24(2) exclude the sums subscribed by members by way of Founders' Contributions and Entrance Fees;
- (iii) Whether, on a proper construction of the provisions of section 24(1), having regard to the evidence adduced before the Board of Review, the Appellant was carrying on a 'club or similar institution'.

The judgment of the Court, delivered by Cons J.A. on 13th July 1983, decided, first, that the appellant was not carrying on a club or similar institution; but that, secondly, the appellant was carrying on a trade association; and, thirdly, that neither entrance fees nor Founders' contributions ranked with the monthly subscriptions as "subscriptions", with the consequence that more than half (in fact the whole of) its receipts by way of subscriptions were from persons who could claim such sums as allowable deductions, and therefore the appellant was caught by sub-section (2).

Their Lordships will address themselves, first, to the claim that the appellant "carries on a club or similar institution". The Court of Appeal denied the appellant the status of a club because it was the common understanding, supported by a number of authorities, that a club was an association formed for other than business purposes. It was of crucial importance that the association should not exist for the financial advantage of its members (except merely as incidental to the general purpose) and a predominant intention to benefit members financially was

by itself sufficient to prevent an association ranking as a club.

In *Fletcher v. I.T.C.* [1972] A.C. 414, at page 422, the Board accepted that a voluntary association of persons who agree, under their own committee of management, to maintain an establishment for their common personal benefit and not for profit, and to defray the expenses thereof by contributions of amounts sufficient for that purpose, could properly be described as a club. It was the appellant's contention that it fulfilled all these conditions. It did not operate for profit. It was not a purpose of the appellant to make a profit for itself. The "personal benefit of members" could include the assistance of members in the advancement of their own business interests. The fact that the appellant helped its members to make profits for themselves was immaterial to the status of the appellant as a club or similar institution.

Their Lordships are in agreement with the Court of Appeal that the appellant cannot properly be described as a club for the reason which they gave, namely that the appellant exists to aid the profit-making activities of its members. As found by the Board of Review, its principal object is to provide a place where its members can carry on their business. There is no justification for drawing a distinction between a mutual association the purpose of which is to make profits for itself, and a mutual association the purpose of which is to assist members to make profits for themselves, and while denying the status of a club to the former, to accord such status to the latter. Their Lordships therefore answer the third question in the negative.

Their Lordships turn to the first question, whether the appellant "carries on a trade association". This is not an expression defined in the Ordinance, nor is "trade" defined in an adjectival sense. In a substantive sense it is defined by section 2 as including "every trade and manufacture, and every adventure and concern in the nature of trade". Part IV of the Ordinance makes liberal use of the three-fold expression "trade, profession or business", and sometimes of "trade or business" alone, but in the opinion of their Lordships these uses throw no light on the meaning to be given to the composite expression "trade association".

The word "trade" is no doubt capable of bearing a variety of meanings according to the context in which it is used. In its most restricted sense it means the buying and selling of goods; in a slightly wider sense, it includes the buying and selling of land;

there is no reason to exclude, in an appropriate context, the buying and selling of choses in action. It is commonly used "... to denote operations of a commercial character by which the trader provides to customers for reward some kind of goods or services"; *Ransom v. Higgs* [1974] 1 W.L.R. 1594 at page 1600.

The appellant advanced the following argument against its classification as a trade association. It is apparent from the wording of the Act that a distinction is to be drawn between a trade on the one hand and a profession or business on the other hand. The appellant answers more naturally to the title of a professional or business association than to the title of a trade association. The word "trade" in the context of section 24 (2) should be restricted to the buying and selling of goods. Although a stock broker is engaged in the buying and selling of shares, he does so only as an agent for his clients. He does not buy or sell on his own account. Furthermore his involvement in buying and selling shares is only one of the functions which he performs for his clients. Of equal importance is his role as a person exercising specialist professional skills in giving advice to his clients. For these reasons stock brokers are properly to be regarded as carrying on a business or a profession rather than carrying on a trade, and the appellant is therefore a business or professional association and not a trade association.

The Court of Appeal rejected these submissions, rightly in the opinion of their Lordships. A stock exchange is unquestionably a market. It is frequently so described. The expression stock "market" is in common use. Stocks and shares are traded in that market. The trading in that market is done by brokers, who are therefore traders. An association which is formed by traders to hold and manage premises for the purposes of their trade is a trade association. Their Lordships answer the first question in the affirmative.

The final question is whether either or both the entrance fees (\$5,745,000) and Founders' contributions (\$350,000), neither of which are tax deductible, can be grouped with the monthly subscriptions (\$130,660), which are tax deductible, so as to raise the non-deductible proportion of the "receipts by way of subscriptions" above the half way level.

It is not arguable that the legislature used the word "subscription" in a sense wide enough to include "entrance fee". The word "subscriptions" is used on its own in the opening words of section 24 (2). In the later part of the sub-section it is used in conjunction with "entrance fees" as a separate and distinct ingredient of "the whole of the income of

such association from transactions". It is also distinguished from "subscriptions" in sub-section (1). It inevitably follows that "subscriptions" does not include "entrance fees", by virtue of the dictionary which the section itself provides.

"Founders' contributions" are a similar case. They, like entrance fees, are once-for-all payments. They lack the recurrent quality of "subscriptions". If, as is clear beyond argument, the sub-section uses the word "subscriptions" in a sense which excludes entrance fees, it must logically follow that "Founders' contributions" are also excluded. A "Founders' contribution" entitles the Founder to a seat on the exchange. It bears all the hallmarks of an entrance fee, with certain additional characteristics - it is paid by only 14 named Founders; it confers certain rights of nomination and a seat on the committee; it is expressed as a contribution towards the establishment of the appellant; and it exempts the Founder from the payment of monthly subscriptions. None of these special characteristics which distinguish a Founders' contribution from an entrance fee are apt to detach it from its affinity to an entrance fee and to qualify it as a subscription. ~~For these and similar reasons stated in the~~ judgment of the Court of Appeal their Lordships answer the second question in the affirmative.

Their Lordships will humbly advise Her Majesty that this appeal should be dismissed. The appellant must pay the costs.

