Pinetree Resort Pte Ltd v Comptroller of Income Tax
[2000] SGHC 24

Case Number : DA 25/1999

Decision Date : 17 February 2000

Tribunal/Court : High Court

Coram : Tan Lee Meng J

Counsel Name(s) : Stanley Lai (Lee & Lee) for the appellants; Foo Hui Min for the respondents

Parties : Pinetree Resort Pte Ltd — Comptroller of Income Tax

Contract – Contractual terms – Membership of proprietary club – Payment of initiation deposits – Whether initiation deposits interest-free loans from members – Whether classification of deposits as deferred liabilities relevant – Whether deposits a mutuum

Revenue Law – Income taxation – Membership of proprietary club – Payment of initiation deposits – Whether deposits taxable as income

: In this case, the appellants appealed against the decision of the Income Tax Board of Review, which dismissed their appeal against the refusal of the respondent, the Comptroller of Income Tax, to amend two Notices of Assessment dated 18 November 1994 requiring the appellants to pay the sums of $2,115,234 and $122,056.11 for the 1986 and 1989 years of assessment. I dismissed the appellants` appeal and now give my reasons for doing so.

Background

The appellants are the sole proprietors of the Pinetree Town & Country Club (hereinafter referred to as `the club`), which is situated at 30, Stevens Road, Singapore. The club provides social, recreational and sporting facilities to its members. Since its inception, members of the club have had to pay an entrance fee to join it. In December 1985, the maximum number of club members was increased from 3,600 to 4,000. At the same time, the constitution of the club was amended so that potential members were required, when joining the club, to pay a fee, of which 15% constituted the entrance fee and 85% constituted what was termed as an `initiation deposit`.

The dispute between the respondent and the appellants concerns the initiation deposits. The respondent took the view that the initiation deposits are taxable as they are part of the consideration paid by members to join the club. On the other hand, the appellants asserted that while the entrance fees ought to be regarded as taxable income, the initiation deposits are interest-free loans from members of the club and are not subject to tax so long as they remain in the accounts as a deferred liability. The appellants appealed to the Income Tax Board of Review against the decision of the respondent but their appeal was unsuccessful. The appellants then appealed against the decision of the Board.

It would be fruitful at this juncture to look at the arrangements concerning the payment and refund of the initiation deposits. If this is done, one can fully understand why the respondent and the Income Tax Board of Review took the view that the initiation deposits are not interest-free loans from members of the club.

To begin with, an initiation deposit is refundable to a member of the club only if he has remained a member for 30 years. This, by itself, raises no eyebrows. What is worth noting is that no claim for a refund of the initiation deposit can be made by any person who wishes to remain a member of the club. This is because a member who seeks a refund of the initiation deposit after he has been a

member of the club for 30 years is required to terminate his membership. The appellants are thus requiring the member concerned to choose between continued membership of the club or a refund of what the appellants themselves contend is an interest-free loan from the member to the club.

Stringent conditions are applicable to any claim for a refund of initiation deposits. For a start, an initiation deposit is only refundable if a claim is made within six months after the 30th year of membership. If such a claim is not made within the said six months, the right to a refund of the initiation deposit is lost. Note must also be taken of the club`s rules relating to forfeiture of initiation deposits. These rules, which are, without more, clearly out of place in the context of a lender-borrower situation, provide that a member`s initiation deposit is forfeited in the following circumstances:

(a) When he or she becomes of unsound mind.

(b) When he or she is convicted of an offence other than a traffic offence or is adjudged bankrupt or is subject to bankruptcy proceedings.

(c) When he or she resigns from the club.

(d) When he or she dies.

(e) When there are moneys in arrears relating to the outstanding subscription or deposit monies. (The appellants have forfeited some initiation deposits on the ground that overdue accounts had not been settled.)

(f) When the club is dissolved.

A member who leaves the club by selling and transferring his membership to another person is not entitled to a refund of the initiation deposit which he has paid. Instead, the initiation deposit remains in the hands of the club and may be refunded to the transferee member provided the new member has remained with the club for 30 years and meets the stringent conditions laid down for the claiming of initiation deposits. In short, the club`s liability to repay the initiation deposit paid by the member selling the membership is postponed to 30 years from the date of the transfer of membership in the club. If the appellants are right in contending that the initiation deposits are non-taxable interest-free loans, this means that where a membership has passed through innumerable hands, the appellants will retain the relevant initiation deposit indefinitely and need not pay tax on it until the initiation deposit has finally passed into their hands because of a failure by the member concerned to claim it within six months after reaching the 30th year of membership or by virtue of the club`s forfeiture clauses.

The decision of the Income Tax Board of Review

The Income Tax Board of Review, which upheld the decision of the respondent, did not agree with the appellants that the initiation deposits paid to them by members of the club were in law interest-free loans which should not have been treated as income accrued to the appellants. The Board pointed out that there are a number of indicators which, when taken together, make it clear that the initiation deposits are not interest-free loans to the club. The Board furnished six reasons for its decision.

First, the Board noted that the initiation deposits were not described as loans in either the club`s constitution or in any of the forms executed by members for the purpose of joining the club. Had the initiation deposits been intended to be interest-free loans from the onset, there would have been some indication to this effect in these documents.

Secondly, the Board noted that the club`s right of forfeiture and the circumstances under which the initiation deposits could be forfeited by the club are features not commonly found in loan transactions.

Thirdly, the Board pointed out that the transfer fee charged by the club on membership transfers was computed as a percentage of the full admission charge, inclusive of the initiation deposit, and not on the entrance fee alone. The Board noted that the appellants explained that this method of calculating the transfer fee was employed as a matter of administrative convenience and was not evidence of the intention of the parties. However, the Board said that the club`s explanation, when viewed in conjunction with the other facts, could not be accepted. The Board summed up the first three factors already discussed as follows:

> *When viewed individually and in isolation, the above facts are ambivalent and equivocal. But when they are viewed in combination, the clear inference must be that there had been no intention by either party to the transaction to create a debt, nor had the parties contemplated the creation of a debt. The totality of the transaction also militates against a finding that the initiation deposits are loans. The improbability of the members actually applying to the appellants for a refund must also be borne in mind. That would again indicate that the transaction was not a loan.*

Fourthly, the Board pointed out that the Income Tax Act employs the test of accrual and noted that the initiation deposit is due and payable at the time of application of membership because r 15 of the club`s constitution requires the approved application form for membership to be submitted together with, ***inter alia*** , the initiation deposit. As such, the Board accepted that the appellants earned the initiation deposit when membership in the club was granted to an applicant. The fact that the appellants may have to refund the initiation deposit at a future date does not, without more, show that the said deposit is not income. The Board pointed out that there are many cases which show that the possibility of a refund does not, by itself, prevent a payment from being taxed.

Fifthly, the Board took the view that the initiation deposit scheme may be characterised as a `contractual buy-back` scheme. The Board pointed out that the refund of initiation deposits does not merely involve the payment of money by the appellants to members who satisfy the conditions set out in r 20A of the club`s constitution. Those who claim a refund of their initiation deposits are required to terminate their membership in the club. This is a very strong indication that the arrangement in question is a contractual buy-back of the membership in the club rather than an interest-free loan from members of the club.

Sixthly, the Board said that club membership was more than a mere personal right to use club facilities. Club membership is a chose in action or some other form of intangible right if only because it is transferable. The point which was made by the respondent was that if the initiation deposit was indeed a loan, one would have expected that upon the sale of the membership by a member, there would have been some documents evidencing the transfer or assignment of the debt from one creditor to another. However, in this case, there was none.

For the reasons stated above, the Income Tax Board of Review dismissed the appellants` appeal.

The appeal

The grounds on which the appellants attacked the decision of the Income Tax Board of Review include the following:

> *(a) The Board manifestly erred in its classification of the said initiation deposits as taxable income merely because such transactions were not described as `loans` either in the club`s constitution or the membership forms.*
>
> *(b) The Board incorrectly made a finding without any basis, on the improbability of members actually applying for and obtaining refunds under the appellants` membership.*
>
> *(c) The Board erred in finding that the initiation deposits had `come home` to the appellants.*
>
> *(d) The Board erred in classifying the transaction in question as a `contractual buy-back` scheme.*
>
> *(e) The Board gave insufficient weight to the accounting treatment of the initiation deposits, which were classified in the appellants` books as deferred liabilities.*
>
> *(f) No deductible expenses are likely to be refunded by the respondents in the 30th year of accounting, and especially so if the initiation deposits are held to be taxable income accruing at the point of payment of membership fees.*
>
> *(g) The Board failed to draw a material distinction between entrance fees, which constitute consideration, and initiation deposits, which are in fact loans from members.*
>
> *(h) The Board failed to note that the initiation deposits constitute a mutuum (quasi-bailment).*
>
> *(i) The Board failed to note that the appellants were giving effect to what the parties have contractually agreed upon in the club constitution.*

At the outset, it ought to be noted that it is often not easy for a tax payer to persuade the court to overrule a decision of the Income Tax Board of Review. In **Mount Elizabeth (Pte) Ltd v Comptroller of Income Tax** [1986] SLR 421 , 429, Chan Sek Keong JC, as he then was, summed up the position in the following succinct terms:

> *In the context of Lord Radcliffe`s speech in **Edwards v Bairstow & Harrison** [1955] 36 TC 207 and the Court of Appeal`s decision in **CBH v Comptroller of Income Tax** [1982] 1 MLJ 112 as to the test an appellate body must apply in hearing an appeal of this nature, the submissions of counsel for the applicant can be distilled and encapsulated into one contention, and that is, the Board erred in law in that no reasonable body of members constituting an Income Tax Review Board could have reached the findings reached by the Board in this instance. When the appellant`s appeal is reduced to this dimension, it becomes apparent that, in this appeal, the appellant has a heavy burden to discharge before achieving lift off.*

For the purpose of this appeal, the starting point must be s 10 of the Income Tax Act (Cap 134, 1996 Ed), which provides as follows:

> *Income tax shall, subject to the provisions of this Act, be payable at the rate or rates specified hereinafter for each year of assessment upon the income of any person* ***accruing*** *in or* ***derived*** *from Singapore or received in Singapore from outside Singapore in respect of -*
>
> *(a) gains or profits from any trade, business, profession or vocation, for whatever period of time such trade, business, profession or vocation may have been carried on or exercised.*

Under s 10 of the Income Tax Act, income which accrues to the taxpayer is subject to tax. In this appeal, the main issue is whether or not the appellants are right in contending that the initiation deposits did not accrue to them in the year of payment because they are interest-free loans from members of the club. As such, if the initiation deposits cannot be characterised as interest-free loans and if the question of quasi-bailment does not arise, the appeal must be dismissed.

The main plank in the appellants` argument that the initiation deposits are non-taxable interest-free loans from the members of the club is that the said deposits may have to be refunded to members under certain conditions after 30 years of membership of the club. If this is the only consideration, there might have been some merit in the appellants` argument that the initiation deposits cannot be regarded as income which has accrued to them. However, the conditions which must be complied with before a member is entitled to a refund of the initiation deposit and the varied circumstances under which the initiation deposit may be forfeited by the club totally remove the ground on which the appellants` argument stands. The appellants relied on, inter alia, ***Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation*** 14 ATD 98 to show that the Income Tax Board of Review erred. This Australian case is irrelevant to the present case as it involved an advance payment of fees. In the present case, the appellants have accepted that the initiation deposit is not a payment in advance for food and beverage, subscriptions or services.

The appellants` counsel rightly pointed out that for the purpose of determining whether the initiation deposits are interest-free loans, the answer does not depend on a labelling exercise by the appellants. After all, in **IRC v Wesleyan and General Assurance Society** [1948] 1 All ER 555; 30 TC 11, Viscount Simon, who pointed out that the name given to a transaction by the parties concerned does not necessarily decide the nature of the transaction, added that the question always is what is the real character of the payment and not what the parties call it. In this context, the appellants have no basis for asserting that the Board erred by classifying the initiation deposits as taxable income merely because such transactions were not described as `loans` either in the appellants` constitution or the membership forms. Admittedly, the Board stated that had the initiation deposits been intended to be loans from the onset, there would have been indications to this effect in the constitution or in the forms executed by persons applying to join the club. However, the Board did not view this lack of documentation in isolation from other facts. Indeed, it made it clear that when the lack of documentation is viewed in combination with other factors, `the clear inference must be that there had been no intention by either party to the transaction to create a debt`. For good measure, the Board opined that the totality of the transaction also militates against a finding that the initiation deposits are loans.

While on the subject of labels, it should also be noted that the fact that the appellants` accountants have classified the initiation deposits as `deferred liabilities` cannot, without more, be conclusive of the matter for as Lord Denning MR pointed out in **Heather (Inspector of Taxes) v PE Consulting Group Ltd** [1973] Ch 189, 217; [1973] 1 All ER 8, 13, while the courts have always been assisted greatly by the evidence of accountants and their evidence should be given due weight, the courts have never regarded themselves as being bound by it. Indeed, his Lordship stressed that it would be wrong for the courts to regard themselves as being bound by accounting practices.

The concept of a `loan` is elucidated in ***Chitty on Contracts*** (28th Ed), Vol 2, at p 700, in the following terms:

> *A contract of loan of money is a contract whereby one person lends or agrees to lend a sum of money to another, in consideration of a promise express or implied to repay that sum on demand, or at a fixed or determinable future time, or conditionally upon an event which is bound to happen, with or without interest.*

As it is elementary that a loan is repayable to the lender in due course, the club`s stringent limitations on the right of members to claim a refund of their initiation deposits and the club`s rules on forfeiture of initiation deposits make it impossible for the appellants to contend that the initiation deposits are interest-free loans from the members of the club. The rule that a member`s initiation deposit is forfeited if he or she commits an offence other than a traffic offence, or is in arrears in his or her dues, or is bankrupt, clearly points to the initiation deposit being not an interest-free loan. Thus, the Income Tax Board of Review rightly said as follows:

> *It would seem to be a highly unusual loan if the loan could be forfeited by the debtor upon the creditor`s resignation from a certain organisation (r 20), or if the creditor was to become of unsound mind, adjudicated bankrupt, subjected to winding up proceedings or convicted of an offence other than a traffic offence (r 21). Indeed, if the initiation deposit had truly been intended to be a loan, then it would seem likely that a member would like to have his money back in case of a bankruptcy. Similarly, if a member is found to be of unsound mind, then surely his family members would also like to recover the money paid to the Appellants.*

I endorse the Board`s view. There is no reason why a borrower should, without more, be entitled to profit when the lender has, for instance, been found guilty of assaulting another person or for forging another person`s signature. As for the club`s claim that it is entitled to forfeit the initiation deposit of a bankrupt member, a question arises as to whether the club is entitled to put itself ahead of the bankrupt member`s creditors if the said deposit is in fact an interest-free loan from the said member to the club.

The fact that a member of the club has to resign in order to get his initiation deposit back also militates against the initiation deposit being an interest-free loan. A member who lends his association money does not, in the ordinary course of events, have to leave the association in order to claim back his own money without interest at an agreed date in the future. The Income Tax Board of Review took note of this and said as follows:

> *The refund of the initiation deposit does not merely involve the payment of*

> *money by the appellants to a member who satisfies the conditions set out in r 20A, but also requires the member to terminate his membership in the club. The indication is, therefore, very strong that the arrangement is not a loan but a contractual buy-back of the membership in the club, and we do find that that is the legal nature of the entire arrangement between the appellants and members in the club involving the payment and refund of initiation deposits.*

The Board is certainly entitled to view the situation as a `contractual buy-back` scheme and not the refunding of interest-free loans. The appellants asserted that as the contracting parties are at liberty to determine the terms of their agreement, the condition relating to termination of membership cannot be held against them. This cannot be countenanced. When referring to this term as well to as the forfeiture clauses, the Income Tax Board of Review pointed out as follows:

> *It is of course true that the contractual terms pertaining to the initiation deposits are open to the parties, viz the club and its members to decide. But in the absence of express evidence of the parties` intentions at the time of the contract, their intentions must be inferred. We find that the unusual nature of the forfeiture clauses, although not decisive in itself, would nonetheless be inconsistent with an inference of a loan.*

For a better perspective of what may properly be regarded as loans to a club, one may consider the arrangements for loans from members of the Raffles Marina and the Laguna National Golf and Country Club. The appellants tried to put themselves in the same position as these clubs but it is evident that the shoes did not fit. To begin with, the Raffles Marina and the Laguna National Golf and Country Club, unlike the appellants, made it absolutely clear from the very start that they were taking loans from their members. Unlike the appellants` club, which sits on freehold land, the Raffles Marina and the Laguna National and Golf Club sit on land which is leased to them for a short period. Thus, the Raffles Marina and Laguna National and Golf Club arranged for the loans from their members to be repayable on a fixed date. A trust deed was made between these two clubs and a trustee corporation, namely, the British & Malayan Trustees Ltd, which agreed to act for the benefit of the holders of unsecured notes issued with respect to the loans. Rules 2.3 and 3.3 of the trust deed provide that the corporate and non-corporate secured notes shall, as between the holders thereof, rank pari passu and rateably without discrimination or preference as an unsecured obligation of the company ranking, subject to such exceptions as may from time to time exist under applicable law, pari passu with all other present and future unsecured obligations other than subordinated obligations, if any, of the company. Furthermore, the trust deed contains sufficiently stringent safeguards to ensure that the members are repaid their loans. Clause 4.1 of the trust deed provides as follows:

> *The Company hereby covenants with the Trustee that as and when the [unsecured notes] or any part thereof become due to be redeemed in accordance with the provisions of these presents the Company will unconditionally pay to the Trustee at the registered office of the Trustee ... the principal amount of the [unsecured notes] or any part thereof which is then due to be redeemed in accordance with the provisions of these presents.*

Another important difference between the Raffles Marina and the Laguna National Golf Club loans and the initiation deposits in this case is that while the appellants` members are required to reclaim their initiation deposits within six months after the 30th year of membership, the members of the Raffles Marina and Laguna National and Golf Club have a period of six years after the date fixed for the refund

of the loans to claim their money. It is only after the said six years that the question of forfeiture of money loaned arises. Before any such forfeiture, the trustees may require stringent efforts to locate the members. Clause 17.1 of the trust deed provides as follows:

> *... Provided that the Trustee before being required to make any such repayment to the Company may at the expense of the Company cause to be published prior to the date of such repayment at least twice and at intervals of not less than twenty-one (21) days in `The Straits Times` in Singapore ... a notice that such moneys remain unclaimed and that after the date stated therein (not being less than twenty-one (21) days after the date of the second such notice) any unclaimed balance of the said moneys then remaining shall be returned to the Company.*

Looking at the thorough way in which the Raffles Marina and the Laguna National and Golf Club handled the situation, including the setting up of trust deeds, the appointment of trustees and the clear acknowledgement from the very start that they borrowed money from their members, it is not surprising that the Comptroller of Income Tax was persuaded that the Raffles Marina and the Laguna National and Golf Club took loans from their members. The appellants are of course not required to follow every step taken by the Raffles Marina and the Laguna National Golf and Country Club in order to prove that the initiation deposits collected by them are interest-free loans from their members. However, by not following the Raffles Marina and the Laguna National Golf and Country Club in making it so clear that loans are being sought from their members and by having unusual clauses relating to forfeiture of the initiation deposits, the appellants made it much easier for the Income Tax Board of Review to conclude that the initiation deposits are not interest-free loans from the members of the club.

I now turn to the appellants` contention that they are not entitled to a tax deduction for any deposit refunded to a member who has made a claim within the prescribed period after the 30th year of membership. The Income Tax Board of Review, which pointed out that whether or not the respondent has the power to grant tax deductions to the appellants for refunds of initiation deposits is not an issue which has to be decided in this case, nonetheless added that s 14(1) of the Income Tax Act does not preclude the deduction of expenses incurred in a particular year of assessment with respect to income produced during a prior period of assessment. In any case, counsel for the respondent aptly noted that it is strange that the appellants should insist that a refund of an initiation deposit is not deductible when the respondent, the national tax authority, has stated time and again that a deduction will be allowed for the refund of initiation deposits with respect to the income generated in the year the initiation deposits are refunded.

The appellants` attempt to avoid payment of tax by classifying an initiation deposit as a mutuum will next be considered. A mutuum is a loan of something which is not to be returned in specie. Instead, the parties accept that the thing borrowed is to be replaced by something similar and equivalent. In this case, there is a real likelihood that the initiation deposits may not be refunded at all, either because they have been forfeited or a claim for its return has not been be made within six months after the 30th year of membership. As such, the question of a mutuum does not arise. In any case, the full ramifications of classifying a transaction as a `mutuum` have not been worked out by the courts and this is certainly not an appropriate case for the development of the law with respect to a mutuum.

Before agreeing with the respondent that the initiation deposits are taxable when received, the Income Tax Board of Review paid meticulous attention to the club`s constitution, application forms,

minutes of meetings and other documents brought to its notice and concluded that none of them disclosed any hint of a loan. The Board considered the forfeiture clauses and could not reconcile these provisions with the normal incidents of a debtor-lender relationship. The Board also took note of the requirement that a member had to resign in order to claim a refund of his or her initiation deposit. I am satisfied that on the facts, the Board`s findings were not erroneous in law or based on insufficient evidence. As such, the findings of the Board should not be disturbed. In view of this, the appellants` appeal against the decision of the Income Tax Board of Review was dismissed with costs.

Outcome:

Appeal dismissed.