No.35 of 1959

IN THE PRIVY COUNCIL

ON APPEAL

FROM THE SUPREME COURT OF HONG KONG
(APPELLATE JURISDICTION)

BETWEEN

THE COMMISSIONER OF INLAND REVENUE
... ... Appellant

——— and ———

THE FOUR SEAS COMPANY LIMITED
... ... Respondent

CASE FOR THE RESPONDENT

RECORD

1. This is an appeal from a judgment of the Supreme Court of Hong Kong (Appellate Jurisdiction) (Hogan P., Reece and Gregg, Appeal Judges,) dated the 24th day of December 1958 allowing an appeal from the judgment of the Supreme Court of Hong Kong (Scholes J.) dated the 13th day of June 1958 which set aside the decision of the Board of Review dated the 16th day of September 1957 allowing the Respondent's appeal against the determination of the Commissioner dated the 6th day of June 1957 confirming the two assessments in dispute. pp.36-56 pp.22-34 pp. 5-19 pp. 1-5

2. The matter arises upon assessments made on the Respondent Company, (hereinafter called "the Company"), under the Inland Revenue Ordinance of Hong Kong, (hereinafter called "the Ordinance"), for the years 1955/56 and 1956/57, both being joint assessments raised under Section 22 of the Ordinance on the profits of a joint venture carried on during the years in question by the Company and Nam Sing Company, Limited of Djakarta. The substantial question is

whether losses incurred by the Company in its sole trading during the years in question, and including losses carried forward from earlier years, should under Section 19 of the Ordinance be set-off against the Company's share of the profits made in the joint venture. The question turns on the true construction of the Ordinance. The contention of the Appellant is that the losses incurred by the Company in its sole trading cannot be set-off against the profits made by the Company in its joint venture trading, whereas the contention of the Company is that on the true construction of the Ordinance the losses incurred in its sole trading should be set-off against its share of the profits of the joint venture and that accordingly the assessments made on these profits should be reduced to nil by the set-off and discharged.

p. 1 3. The agreed facts in this appeal are as follows:

(1) The Company is a company incorporated in Hong Kong carrying on business in the Colony as importers and exporters.

(2) During the two years ended 31st December 1954 and 31st December 1955 the Company conducted joint ventures in Hong Kong with Nam Sing Company Limited of Djakarta, resulting in profits arising in or derived from the Colony amounting to $49,888 and $73,618 respectively. These profits were shared equally by the two partners.

(3) Apart from its joint venture profits the Company's trading for the above two years resulted in a loss. The Company had also made similar losses during the two previous years, which are available for set-off against future profits.

4. The relevant statutory provisions are contained in the Inland Revenue Ordinance of Hong Kong, Chapter 112 of the Revised Edition 1950, /as amended in the 1956 Reprint/. In particular the case turns on the true construction of the following parts of the

following sections.

'Section 2. "assessable profits" means the net profits for the basis period arising in or derived from the Colony calculated in accordance with the provisions of Part IV but does not include profits arising from the sale of capital assets;

"corporation" means any company which is either incorporated or registered under any enactment or charter in force in the Colony or elsewhere;

"person" includes a company, partnership, or body of persons.'

'Section 14. (1) Corporation profits tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every corporation carrying on trade or business in the Colony in respect of the profits of the corporation arising in or derived from the Colony from such trade or business.

. . . . . .'

'Section 15. (1) Business profits tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person other than a corporation carrying on a trade, profession or business in the Colony in respect of the profits of that person arising in or derived from the Colony from such trade, profession or business.

. . . . . .'

'Section 18. (1) Save as provided in this section, the assessable profits

for any year of assessment from any trade, profession or business carried on in the Colony shall be computed on the full amount of the profits therefrom arising in or derived from the Colony during the year preceding the year of assessment.

(2) Where the Commissioner is satisfied that the accounts of a trade, profession or business carried on in the Colony are usually made up to some day other than the 31st day of March, he may direct that the assessable profits from that source be computed on the amount of the profits therefrom arising in or derivedfrom the Colony during the year ending on that day in the year preceding the year of assessment.

. . . . . .'

'Section 18A. Corporation profits tax shall be charged for each year of assessment at the standard rate on the assessable profits of a corporation for that year ascertained in accordance with the provisions of this Part.'

'Section 18B. (1) Business profits tax shall, subject to the provisions of subsection (2), be charged for each year of assessment at the standard rate on the assessable profits of a person other than a corporation for that year ascertained in accordance with the provisions of this Part.

. . . . . .'

'Section 19. (1) Subject to the provisions of subsection (3) where a loss is incurred in any year of assessment by a person chargeable to tax under this Part the amount of such loss

attributable to activities in the Colony shall notwithstanding the provisions of Section 70 be set off against what would otherwise have been the assessable profits of such person for that year of assessment.

(2) Where the amount of loss which may be set off under subsection (1) is such that it cannot be wholly set off against the assessable profits for the year of assessment in which the loss occurred, the amount not so set off shall be carried forward and shall be set off against what would otherwise have been assessable profits for the future years in succession:

Provided that the amount of any such loss allowed to be set off in computing the assessable profits for any year of assessment shall not be set off in computing the assessable profits for any other year of assessment,

. . . . . .'

'Section 22. (1) Where a trade, profession or business is carried on by two or more persons, jointly the assessable profits therefrom shall be computed in one sum and the tax in respect thereof shall be charged in the partnership name.

(2) The precedent partner shall make and deliver a statement of the profits or losses of such trade, profession or business, on behalf of the partnership, ascertained in accordance with the provisions of this Part relating to the ascertainment of profits. Where

no active partner is resident in the Colony the return shall be furnished by the manager or agent of the partnership in the Colony.

(3) If a change occurs in a partnership of persons carrying on any trade .....

(4) Tax upon the partnership shall be recoverable by all means provided in this Ordinance out of the assets of the partnership, or from any partner.

(5) Tax may be assessed on the profits of a partnership notwithstanding the cessation or dissolution of such partnership and shall be recoverable from the former partners and from the assets of the partnership at the time of its cessation.'

'Section 26. For the purpose of assessment under this Part -

(a) . . . . . .

(b) subject to the provisions of Section 15A no part of the assessable 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 the assessable profits of any other person.'

pp. 1 & 2

5. The notices of assessment that contained the tax in dispute were dated the 10th day of November, 1956 and were made under charge Nos. 11/1039 and IJ/623. The tax in dispute amounts to $3,118 and $4,601 for the two years of assessment 1955/56 and 1956/57 respectively, being corporation profits tax chaged on the

Company's half share of the profits of the joint ventures under a joint assessment on the whole profits of the joint ventures raised under Section 22 of the Ordinance. The Assessor, purporting to act in accordance with Section 26(b), excluded the Company's half share of these profits from the corporation profits tax assessments made on its sole trading under Section 14, with the result that the Company was prevented from setting off the losses incurred in its sole trading against its half share of the joint venture profits.

On the 9th day of November, 1956 the Company gave notice of objection in writing against the two assessments on the grounds that the joint venture profits formed part of the assessable profits of the Company under Section 14, thus reducing the assessable profits of the joint ventures to nil. p. 5

6. On the 22nd day of May, 1957 the Commissioner after hearing the appeal confirmed the assessments and at the request of the Company transmitted to the Company his determination in writing dated the 6th day of June 1957. He held that the assessments were properly made because the joint venture profits were taxable under Section 22 and the Company's share of these profits was then excluded by Section 26(b) from the assessment on its sole trading made under Section 14. pp.1-5

In the course of his determination the Commissioner came to the conclusion that without any doubt the joint ventures came within the words of Section 22. He considered that the only arguable question was the correct application of Section 26(b). This section was designed to stop double taxation in just such a case as this. He was of the opinion that the Assessor's order of priority was correct, namely that the joint venture profits should be assessed first under Section 22 and the Company's share then excluded by p. 2 p. 3 pp. 3 & 4

Section 26(b) from its own assessment under Section 14. He preferred this to the Company's argument, that by virtue of Section 14(2) the joint venture profits must first be included in the Company's own assessment and then by Section 26(b) excluded from the joint assessment under Section 22, because that would make the assessment under Section 22 no longer a joint one as envisaged by the section. He also considered that the specific requirement of Section 22 had priority over the general requirements of Section 14(2). He considered that that was the only consistent interpretation of Section 26(b) when read in conjunction with Sections 22, 14 and 15.

He observed that the tax charged on the joint ventures should have been business profits tax and not corporation profits tax since the partnership was "a person other than a corporation" but it had been agreed that Section 63 protected the Assessor from this mistake.

7. The Company appealed to the Board of Review.

pp. 5-10 8. The Board of Review by its decision dated the 16th day of September unanimously allowed the appeal and annulled the

pp.10-19 assessments. Mr. L.J. D'Almada Remedios gave his reasons separately.

The majority of the Board held that Section 22 did not apply to corporations which remained taxable under Section 14 even when engaged in a joint venture. Therefore both the joint venture profits and the sole trading losses of the Company were assessable under Section 14 and could be aggregated.

In the course of their decision the Board after reviewing some authorities

pp. 7 & 8 first rejected the Company's argument that if Section 22 was applicable to corporations then Section 26(b) gave the Company the right to elect as to the order of priority of Sections 22 and 14. They said that the

wording of Section 26(b) was plain and that there was no authority for the proposition that the taxpayer should be allowed to opt for whichever application was the more favourable to him, whereas there was authority that in certain United Kingdom cases the Crown could elect while the taxpayer could not.

The Board then considered whether a corporation engaged in a joint venture remained chargeable under Section 14(1) for corporation profits tax or was chargeable under Section 22 for business profits tax. It appeared to them that if Section 22 applied to corporations then a corporation which only did business in the nature of joint ventures must pay tax on each joint venture which made a profit and could not off set the losses on the unprofitable joint ventures; however each joint venture profit of less than $7,000 would be free of tax under Section 18B(2). The manifest absurdity of these results led the Board to the conclusion that some limitation must be put on the meaning of the word "person", defined in Section 2 as including corporations, when it came to construing Section 22 and that "person" in that section did not include corporations. They found authority for so doing even though the word was included in a definition section. They concluded by holding that Section 22 did not apply to corporations which remained taxable under Section 14 even when engaged in a joint venture. p. 9 p.10

Mr. L.J. D'Almada Remedios said that he came to the same conclusion for different reasons. Section 14 appeared to subject all the profits of a corporation to corporation profits tax. Section 22 as a result of the definition in Section 2 appeared to cover all partnerships consisting of individuals or corporations. If the Ordinance allowed taxation under alternative methods, the selection of the alternative lay with the Crown and not the taxpayer and therefore the Crown having chosen Section 22, Section 14 would be excluded by Section 26(b). But Section 22 p.11 p.12 p.13 p.14

was in apparent conflict with Section 15 because under Section 22 the Crown could exact payment from a corporation for business profits tax and Section 15 clearly excluded corporations from business profits tax. No repugnance or
p. 15 inconsistency between the two sections would arise if the word "person" in Section 22 were limited to its ordinary meaning and not given the meaning as extended in Section 2 to include corporations. The words in Sections 14,
p. 16 15 and 22 were sufficiently flexible to admit of that construction. It was apparent that the intention of the Legislature would be better effectuated by imposing corporation profits tax on all the profits of a corporation including those derived from a joint venture.

p. 18 He therefore held that the profits in question fell directly within the charging words of Section 14.

p. 19 9. By a supplementary Decision dated the 27th day of September 1957 the Board of Review held that the same principles applied to the other partner in the joint venture, Nam Sing Company Limited, and accordingly reduced the assessments.

10. The Commissioner of Inland Revenue
pp.20-22 appealed by way of a case stated by the Board of Review dated the 7th day of November 1957.

The questions of law raised by the case stated for the opinion of the court were whether the Board was right in deciding:-

(1) That the Company was taxable under Section 14 in respect of its share of the joint venture profits

(2) That Section 26(b) should not be construed so as to give the Company a right to elect whether the joint venture profits should be taxed under Section 22 or Section 14.

11. The Supreme Court of Hong Kong

(Scholes J.) allowed the appeal and reversed the decision of the Board of Review by a judgment dated the 13th June 1958. The learned Judge held that the Company was liable to tax on the joint venture profits under Section 22, and rejected the argument that Section 26(b) gave the Company a right to elect that those profits should be taxed under Section 14. pp.22-34

Scholes J., after reviewing the arguments and the sections, agreed that the Board of Review was right to hold that if Section 22 was applicable then Section 26(b) did not give the Company the right to elect whether Section 22 or Section 14 should be applied. He went on to consider the Board's decision that Section 22 did not apply to a corporation. In his opinion interpreting the sections in their plain ordinary meaning would cause no ambiguity, inconsistency or repugnance in the Ordinance but might cause hardship. The plain meaning of Sections 2 and 22 meant that the profits in question were assessable under Section 22. Section 26(b) then operated to stop the Company's share of the profits of the joint venture being taxed again under Section 14. The authorities established that, unless the ordinary meaning of the relevant words produced an absurdity so great as to convince the court that the Legislature could not have intended to use the words in their ordinary meaning, that ordinary meaning should be followed. In the present case the words did not produce such an absurdity and Sections 2 and 22 should be given their plain meaning and therefore the Company was taxable under Section 22 without any relief for its losses. pp.25-31 p. 32 p.33 p.33 p.34

12. The Company appealed against the decision of the Supreme Court by a Notice of Appeal dated the 16th day of July 1958, on two grounds:- p.35

(1) That the learned Judge was wrong in holding that Section 22 applied to corporations.

(2) That the learned Judge wrongly rejected

the Company's argument that the profits of the joint venture were taxable under Section 14 and were then excluded from Section 22 either because the Crown's right to tax had been exhausted or alternatively because of the operation of Section 26(b).

13. The Supreme Court of Hong Kong (Appellate Jurisdiction) (Hogan P., Reece and Gregg, Appeal Judges,) allowed the appeal
pp.36-56 and reversed the decision of the Supreme Court by a judgment dated the 24th December, 1958. The court held that the Company could set-off its sole trading losses against its joint venture profits under Section 19 because Section 22 did not establish the joint venture as a separate entity so as to preclude such a set-off under Section 19. The court also held that Section 22 did apply to corporations and that Section 26 (b) did not give the taxpayer a right to elect that the profits should not be taxed under Section 22.

p. 37 At the beginning of the judgment the Court noted that it might be argued that the agreed facts did not show sufficient continuity in the joint venture to bring it within Section 22. There was however not enough evidence to enable the point to be considered and consequently they made no decision on the point.

p. 38
p. 39 After considering the decision of the Board of Review the court said that under Section 19(1) a corporation could set-off losses incurred in sole trading against the profits of a joint venture provided that it was the same person that made both the profits and the losses. The whole substance of the Crown's contention was that Section 22(1) created a separate taxable entity distinct from the taxable entity of the Company which had incurred the losses. The court then considered whether the words of Section 22 (1) were in effect sufficient to make the "partnership name" a new entity. In comparing the chargeable entities already
p.40 created by the Ordinance they noted that Sections 14 and 15, the principal charging

sections, provided that tax would be charged "on" the particular taxpayers whilst Section 22(1) charged tax "in" the partnership name. This language could be said to imply that Section 22(1) was merely machinery indicating the channel through which tax already imposed should be extracted, as indeed Counsel for the Appellant had suggested. They found guidance in favour of this view of the use of the word "in" from Sections 10, 20(2) and 20A(1). p.41

Their impression was strengthened by an examination of the English Income Tax Act 1952. Section 22 (1) appeared to be derived from Section 144 of the English Act but omitted the following words of the English section "shall be separate and distinct from any other tax chargeable on those persons or any of them". The omission of these words from Section 22 weakened the argument that the section set up a separate entity; and their presence in the English section clearly implied that the section was separating a particular tax from other taxes on those persons and not setting up a taxable entity separate from those persons. p.42

Section 22(4) made the partnership tax a joint and several liability of the partnership and of the individual partners. This implied that the Legislature looked on the partnership as something dependent on the partners and not as an entity separate from them.

The court considered in detail the case of Commissioners for General Purposes of Income Tax for City of London v Gibbs and Others /1942/ A.C.402. The case appeared to support the Crown's contention in that the House of Lords found that the English Income Tax Legislation had made a partnership an entity of assessment sufficiently distinct from the partners composing it to enable the House to regard the addition of a new partner as "a succession" for the purposes of Rule 9 of the Rules applicable to Cases I and II of Schedule D of the Income Tax Act 1918 to the business previously carried on by the old partnership. But the House of Lords had recognised that generally in England - and the pp.43-48 p. 48

position was the same in Hong Kong - the firm name was merely a compendious description for the persons composing it. The essence of the decision was that the
p. 49 introduction of one or more new partners caused a succession for the purposes of the relevant rule since there was a change in the persons engaged in carrying on the business. This decision emphasised the continuing identity of the partners with the firm.

The court then considered the case of Worth v Commissioners of Inland Revenue /1953/ 1 W.L.R.584. This case, they said, emphasised the limitations to be put on the Gibbs case and the point in issue was much
p. 52 closer to the case before them. In view of that case they asked themselves whether it would be right in the present case to hold that there was such a distinction between the partnership which had made the profits and the component partner which had made losses elsewhere that there was not a sufficient common identity to permit those losses to be set-off under Section 19.

Before answering that question, the court considered why in England, if there was no such distinction, Section 142 Income Tax Act 1952 expressly provided for setting off losses incurred "solely or in partnership". The answer appeared to be that this was incidental to the main purpose of the section, which was to ensure set-off between distinct trades, but that it did in fact allow a set-off where the same trade was carried on as to some part solely and as to some part in partnership. The same applied to Section 341 Income Tax Act 1952.

The court next considered whether in the absence of express statutory provision the rule that joint liabilities could not be set-
p. 53 off against claims that are not joint applied. In Hong Kong Section 22(4) made each partner severally liable for the whole of the tax on the partnership and under Section 19(1) it was chargeability to tax that attracted set-off. Therefore a clear channel for set-off for the partners semmed

to have been established. In England it appeared that the same result would be reached in the absence of any statutory counterpart of Section 22(4). It seemed to them that neither Section 144(1) Income Tax Act 1952 in England, nor Section 22(1) in Hong Kong imposed a liability on something distinct from the partners. p. 54

Section 22(3) also implied that a partnership was not an entity distinct from the partners. p. 55

For all these reasons the court came to the conclusion that Section 22 did not prevent the partners, whether individuals or corporations, setting off their losses against their profits under Section 19 and accordingly the Commissioner had been wrong to disallow the set-off.

The question whether a corporation was a person within the meaning of Section 22(1) was only a step in the argument and not the real point in issue. Having regard to the definition in Section 2 they thought that Scholes J. was right to hold that Section 22(1) applied to corporations. p. 56

They agreed with the opinion of Scholes J. and of the Board of Review that Section 26(b) did not give the taxpayer a right of election to prevent profits being assessed under Section 22.

14. An order granting to the Appellant final Leave to Appeal to Her Majesty in Council was made on the 3rd day of March 1959. p. 57

15. The Respondent humbly submits that the decision of the Supreme Court of Hong Kong (Appellate Jurisdiction) is right and should be affirmed and that this Appeal should be dismissed with costs for the following amongst other

R E A S O N S

1. BECAUSE, being a corporation, the Company is properly chargeable under Section 14 of the Ordinance

in respect of its share of the profits of the joint venture.

2. BECAUSE, the provisions of Section 22 of the Ordinance dealing with the computation, assessment and collection of tax when a trade is carried on by two or more persons jointly do not create a separate liability to tax distinct from the liability for tax charged under Section 14 or Section 15 of the Ordinance.

3. BECAUSE, the persons chargeable to tax where an assessment is made in the name of a partnership under Section 22 of the Ordinance in respect of the profits of a joint venture are the partners, being the persons by whom the trade is carried on.

4. BECAUSE, notwithstanding the provisions of Section 22 of the Ordinance the Company is by virtue of Section 14 and Section 18A of the Ordinance chargeable to corporation profits tax for the relevant years of assessment at the standard rate on its assessable profits for those years including its share of the profits of the joint venture.

5. BECAUSE, by virtue of Section 19 of the Ordinance the Company is entitled to have its losses (being losses attributable to trading activities undertaken on its own account) set off against what would otherwise have been its assessable profits for the relevant years of assessment (being its share of the profits of the joint venture).

6. BECAUSE, the decision of the Supreme Court of Hong Kong (Appellate Jurisdiction) was right.

H.H. MONROE

PHILIP SHELBOURNE

No. 35 of 1959

IN THE PRIVY COUNCIL

O N A P P E A L

FROM THE SUPREME COURT OF HONG KONG (APPELLATE JURISDICTION)

B E T W E E N

THE COMMISSIONER OF INLAND REVENUE ... Appellant

—— and ——

THE FOUR SEAS COMPANY LIMITED ... Respondent

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