Privy Council Appeal No. 35 *of* 1959

The Commissioner of Inland Revenue – – – – – *Appellant*

v.

The Four Seas Company Limited – – – – – *Respondents*

FROM

THE SUPREME COURT OF HONG KONG

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 27TH NOVEMBER 1961

Present at the Hearing:

LORD DENNING
LORD DEVLIN
MR. L. M. D. DE SILVA
[*Delivered by* LORD DEVLIN]

These appeals are concerned with two assessments to tax made upon the respondent company for the years 1955/56 and 1956/57 under the Inland Revenue Ordinance of Hong Kong. The Ordinance does not impose a general tax on income but separate taxes on separate categories of income, and this case is concerned with two such taxes, a corporation profits tax and a business profits tax. The former is imposed by section 14 of the Ordinance upon " 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 ". The business profits tax, imposed by section 15, is a similar tax on profits charged on " every person other than a corporation carrying on trade ", etc.

The respondents are a corporation which during the relevant years carried on business in the Colony in two compartments, to use a neutral term, one in which they were trading solely on their own account and where they made a loss, and the other trading in partnership with another company where they made a profit. Various questions about the respondents' liability to tax have been argued before the Courts of Hong Kong, but the only one which the Board has been invited to consider is the one which in the end emerged before the Supreme Court of Hong Kong (Appellate Jurisdiction), namely, whether the respondents are entitled to set off the loss they made in their sole trading against the profits made in partnership. The relevant section of the Ordinance is section 19 (1) which provides that " 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 . . . be set off against what would otherwise have been the assessable profits of such person for that year of assessment ".

The respondents' case on this point is clear and simple. Whether the business they did was done solely or in partnership, it was business done by them as a corporation. As a corporation they are liable under section 14 to pay corporation profits tax on their share, a half share, of the profits made by the partnership; but as against that share they can under section 19 set off the loss made by them as a corporation in their sole trading.

The Commissioner's case is more complex. The respondents, the Commissioner says, are not liable to corporation profits tax at all because as a corporation they made a loss. The business done by the partnership was

not done by the partners but by the firm, which is to be treated as a person distinct from its partners. As such person it is a " person other than a corporation " within the meaning of section 15 (it being immaterial that the partners are corporations and not individuals) and the profits which it made are subject, not to corporation profits tax, but to business profits tax under section 15. On this basis the Commissioner contends that section 19 (1) is not applicable. Undoubtedly the person who incurred the loss within the first part of the subsection is the respondent corporation; but the respondent corporation had no " assessable profits " within the second part of the subsection because the person who made the assessable profits was the firm and not the respondent corporation.

If the case for the Commissioner had to be tested in the light of ordinary principles of law, it would be impossible to sustain. It is well established that in English law, which in this respect applies in Hong Kong, a firm or partnership has no legal personality distinct from that of its partners. Nevertheless, it is possible for tax legislation to be so devised as to require a firm for certain purposes to be treated as a separate entity. In *E. P. Gibbs* (1940) 24 T.C.221 the House of Lords held that the effect of Rules 9 and 10 of the Rules applicable to cases I and II of Schedule D of the Income Tax Act, 1918, was to require the firm to be treated for the purposes of those Rules as an " entity of assessment ". This is the term used by Lord Macmillan at 247 and Lord Porter at 256. Lord Macmillan said:—" The important thing to ascertain is the meaning of the word ' person ' in the vocabulary of the Income Tax Acts. The word constantly occurs throughout the Acts, and I think that it is most generally used to denote what may be termed an entity of assessment, i.e., the possessor or recipient of an income which the Acts require to be separately assessed for tax purposes.".

Their Lordships do not propose to examine any more closely the case of *E. P. Gibbs*. The question before the House was quite different from that which the Board has here to consider and the legislation to be interpreted was, of course, not the same. Their Lordships have referred to the case because it is from the speeches in it that there comes the concept in tax law of an entity of assessment which the Commissioner seeks to use in this case. There is not in the vocabulary of the English Income Tax Acts to which Lord Macmillan referred any express definition of " person " embodying this concept. The Commissioner bases his contentions upon the fact that in the Hong Kong Ordinance there is. In section 2 " person " is defined as including " a company, partnership or body of persons ". The Commissioner does not contend that by these words the Ordinance is creating for its own purposes a new sort of juristic personality. He submits that the effect of the definition is to bring into existence by express words the separate entity of assessment which the House in *E. P. Gibbs* held to emerge as an effect of the Rules they were there considering.

Mr. Monroe for the respondents does not, of course, dispute that the word " person " must where appropriate in the Ordinance be taken to include partnership. Nevertheless he submits that if one bears firmly in mind that, whatever may be meant by an entity of assessment, it is not intended to incorporate a distinct legal personality (and it is clear from the speeches in *E. P. Gibbs* that their Lordships in that case did not so intend it), it does not disturb his argument. He reminded the Board in the words of Lord Dunedin in *Whitney v. Commissioners of Inland Revenue* (1925) 10 T.C. 88 at 110, that there are three stages in the imposition of a tax; the charge or declaration of liability, the assessment and the recovery. In the present case the charge is imposed by section 14 or section 15 of the Ordinance—for the purpose of this argument it does not matter which—on the corporation or person " carrying on a trade, profession or business in the Colony in respect of the profits of that person ". Mr. Monroe concedes that " person " in section 15 includes " partnership ", but the partnership, he submits, is not the person carrying on the trade; it is the partners and not the partnership who carry on the trade and so the partnership, though a person, is not brought within section 15. Consequently, the person who is charged under section 15 can only be the partner; and since the charge is " in respect of the profits of that

person ", the charge is only on his separate share of the partnership profits and not on the partnership profits as a whole. That is the argument on the charging section.

The assessment is undoubtedly governed by section 22 which is entitled "Assessment of partnerships ". Subsection (1) provides:—" 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.". Mr. Monroe relies on the words " carried on by two or more persons jointly " as supporting his submission that the Ordinance is treating the business as carried on by the partners and not by the partnership. His interpretation of the subsection is that it is dealing with computation only and the provision that the tax should be charged in the partnership name is descriptive and does not mean that the partnership is the person chargeable or assessable. As in the case of charge, he submits, the only person assessable is the partner in respect of his share of the profits.

Recovery is provided for by section 22 (4) which says that " tax upon the partnership shall be recoverable . . . out of the assets of the partnership, or from any partner.". Mr. Monroe agrees that under this subsection one partner can be made to pay the tax not only upon his own profits but also on those of the other partner; but submits that that is simply a recognition of the principle that each partner is responsible for the whole of a partnership debt.

Their Lordships are disposed to think that the right interpretation of this group of sections in the light of the definition of " person " as including partnership requires the partnership to be treated as a separate entity for all three purposes of charge, assessment and recovery. But the only one of these three that it is strictly necessary for them to consider in order to decide this case is assessment. For the relevant words in section 19 (1), which governs the point, are " the assessable profits of such person ". Their Lordships cannot interpret section 22 in any other way than to say that where there is a partnership, the partnership is the person who is assessed. Under section 22 only one figure of profit is to be computed, only one sum of tax is to be charged, that sum is to be charged in the partnership name and it is described in subsection (4) as a tax upon the partnership. Their Lordships cannot reconcile these provisions with the submission that there are two assessments, one upon each partner in respect of his share of the profits. Moreover, if this were the effect of section 22 in all partnership cases, it would be unnecessary to provide, as is done by section 42 (2), that in the special case of a partner (who has to be an individual and not a corporation) electing to have a personal assessment, " the assessable profits of the partnership . . . shall be apportioned amongst the partners in the ratio in which the profits or losses for that year of assessment were divided ". Their Lordships are clear that section 22 provides in the case of a partnership for one assessment only. If there is only one assessment, then the person assessed must be the partnership. If so, the partnership must be the person who has the " assessable profits " within the meaning of section 19 (1): and since the partnership is not in this case the person who incurred the loss, the loss cannot be set off against those assessable profits.

Their Lordships, therefore, feel constrained to differ from the conclusion of the Supreme Court (Appellate Juridiction). They have obtained much help from the full and careful consideration of this question in the Supreme Court, but since in the end the question is one of construction, they have felt able to state their own reasons shortly. They will for these reasons humbly advise Her Majesty that this appeal should be allowed and that the judgment of the Supreme Court (Appellate Jurisdiction) dated the 24th December 1958 ought to be varied by it being declared that the respondents are not entitled to set off the loss they made in their sole trading against the profits made in the partnership.

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In the Privy Council

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DELIVERED BY
LORD DEVLIN

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