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50/1961

No. 35 of 1959

68506

IN THE PRIVY COUNCIL

O N A P P E A L
FROM THE SUPREME COURT OF HONG KONG
(APPELLATE JURISDICTION)

UNIVERSITY OF LONDON
W.C.I.
19 FEB 1962
INSTITUTE OF ADVANCED
LEGAL STUDIES

B E T W E E N :-

THE COMMISSIONER OF INLAND REVENUE Appellant

- and -

THE FOUR SEAS COMPANY LIMITED Respondent

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CASE FOR THE APPELLANT

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1. This is an appeal brought by leave from the judgment of the Supreme Court of Hong Kong (Appellate Jurisdiction) delivered on the 24th December 1958 allowing the Respondent's appeal against the judgment of the Supreme Court of Hong Kong (Original Jurisdiction) delivered on the 13th June 1958 which had allowed the Appellant's appeal from a decision of the Board of Review reducing assessments to profits tax made by the Appellant upon the Respondent.

2. The assessments in dispute are in form for corporation profits tax for the years of assessment 1955/56 and 1956/57 being joint assessments upon the Respondent and another corporation and raised under Section 22 of the Inland Revenue Ordinance (Cap. 112) of Hong Kong on the Hong Kong profits of joint ventures. It was, however, agreed between the parties at the beginning of the proceedings herein that the assessments should, consistently with the Appellant's contentions, have been for business profits tax and the case has throughout been argued on that footing.

p. 4 ll.
39-47

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3. The substantial question of law arising on this appeal is whether or not a corporation is entitled to set off against the profits of a trade or business carried on by that corporation and another person jointly losses incurred by it otherwise than in the course of the joint venture.

4. The scheme of the Inland Revenue Ordinance (Cap. 112) of Hong Kong is to impose distinct taxes upon different types of income, namely "property tax" on the rateable value of land or buildings, "salaries tax" on income from offices, employments and pensions, "profits tax" on the profits of trades, professions and businesses and "interest tax" upon payments of interest. Each tax is separately charged and computed but the machinery provisions of the Ordinance, including certain provisions as to assessment, apply to all these taxes and an individual has an option to obtain certain allowances by electing for "personal assessment" on the aggregate of his liability thereto. Further, the "profits tax" just mentioned is itself subdivided into "corporation profits tax" and "business profits tax." The provisions of the Ordinance directly relevant to this appeal are:-

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PART I

Section 2.

"2. In this Ordinance -

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"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;

.....

"body of persons" means any body politic, corporate or collegiate and any company, fraternity, fellowship and society of persons whether corporate or not corporate;

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.....

"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;

.....

"trade" includes every trade and manufacture, and every adventure and concern in the nature of trade;"

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PART IV

Section 14.

"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.

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(2) Any sum arising in or derived from the Colony, other than a sum from the sale of capital assets, received by or credited to a corporation carrying on a trade or business in the Colony shall be deemed to arise from the trade or business carried on."

Section 15.

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"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:

(2) Any sum arising in or derived from the Colony, received by or credited to a person other than a corporation carrying on a trade, profession or business in the Colony shall be deemed to arise from such trade, profession or business:

Provided that any such sum which -

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- (a) is liable to interest tax under Part V;
or
- (b) arises from the sale of a capital asset;
or
- (c) is received by or credited to a person carrying on a trade, profession or business but which derives from his own personal property,

shall not be deemed so to arise."

Section 19.

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"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:

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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.

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....."

Section 22.

"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.

10 (3) If a change occurs in a partnership of persons carrying on any trade, profession or business, by reason of retirement or death, or the dissolution of the partnership as to one or more of the partners, or the admission of a new partner, in such circumstances that one or more of the persons who until that time were engaged in the trade, profession or business continue to be engaged therein, or if a person previously engaged in any trade, profession or business on
20 his own account continues to be engaged in it, but as a partner in a partnership, the tax payable by the person or persons who carry on the trade, profession or business after that time shall, notwithstanding the change be computed on what would otherwise have been the assessable profits of such person or persons or the aggregation of such assessable profits in accordance with section 18 as if no such change had occurred:

30 Provided that on application made in writing by all the persons engaged in the trade, profession or business both immediately before and immediately after the change, and signed by all of them or, in the case of a deceased person, by his legal representative, and received by the assessor within two years after the change took place, the assessor shall compute the profits for any year of assessment as if the trade, profession or business had been discontinued at the date of the change and a new trade, profession or business
40 had been then set up and commenced.

(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

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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.

"26. For the purpose of assessment under this Part -

.....

(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." 10

p. 1 11. 19-35

5. The agreed facts of the case appear from the Appellant's Determination of 6th June 1957 and are :-

(1) The Four Seas Co. Ltd. is a company incorporated in Hong Kong carrying on business in the Colony as importers and exporters. 20

(2) During the two years ended 31st December, 1954 and 31st December, 1955 the company conducted joint ventures in Hong Kong with Nam Sing Co. Ltd. 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. 30

6. Joint assessments were made in reliance on Section 22 of the Ordinance upon the Respondent and Nam Sing Co. Ltd. in respect of the joint venture profits just mentioned. In reliance on Section 26 (b) of the Ordinance, the Respondent's share of these profits was 40

10 excluded from its own assessments to corporation profits tax. The practical effect of this exclusion and of the separate joint assessments was (until the Full Court of the Supreme Court of Hong Kong decided otherwise) considered to be that the Respondent was prevented from applying its losses against its share of the joint venture profits. The tax in dispute amounts to \$3,118 and \$4,601 for the two years of assessment 1955/56 and 1956/57 respectively and represents the tax charged on the Respondent's share of the profits of the joint ventures. The tax charged in respect of the other partner's share of the profits is not in dispute.

20 7. Section 64 of the Ordinance provides that persons aggrieved by any assessment may appeal to the Appellant and on 9th November 1956, the Respondent's representatives gave notice of objection to the Appellant against these two assessments on the grounds that the joint venture profits are assessable under Section 14 of the Ordinance and form part of the assessable profits of the corporation concerned, thus reducing the assessable profits of the joint ventures to NIL. After hearing argument, the Appellant determined that the assessments in question were properly raised in accordance with Section 22 of the Ordinance and that by virtue of Section 26 (b) the Respondent was not entitled to apply its 30 losses suffered in its business generally against its share of the profits of the joint ventures. The Respondent thereupon appealed to the Board of Review.

8. Before the Board of Review it was contended on behalf of the Respondent (the then Appellant):

- 40 (a) that being a corporation it was liable to tax only under Section 14 (1) of the Ordinance and that Section 22 had no application to it because the joint venture activities formed part of its trade; and
- (b) that if in fact Section 22 was applicable, then Section 26 (b) should be so construed as to give the Respondent the right to elect that its share of the profits arising out of the joint ventures should be included in the Respondent's own assessment and excluded from assessment under Section 22.

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It was contended on behalf of the Appellant (the then Respondent) :

(a) that the joint ventures constituted a trade or business carried on by two or more persons jointly; that a corporation was a "person"; and that therefore the Respondent, in respect of the joint ventures, was properly taxable under Section 22 for its share of the profits; and

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(b) that on the wording of Section 22 (b) the principle of "election" contended for had no basis.

The Board rejected the Respondent's second argument, as to election but accepted the first argument, that a corporation is not chargeable to tax under Section 22. Accordingly the Board allowed the appeal and reduced the assessments by the amounts of tax in dispute.

9. The Appellant appealed from the decision of the Board of Review, requiring the Board to state a case for the opinion of the Supreme Court. The appeal was heard in the Supreme Court (Scholes, J.) on the 12th and 13th March, 1958 and on the 13th June, 1958, the Court delivered judgment allowing the appeal.

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pp. 22-31

After referring to the facts of the case, to the decisions of the Commissioner and of the Board of Review to the relevant, statutory provisions and to the contentions of the parties, Scholes, J., considered the first question asked in the case stated, namely whether the Board of Review was right to reject the argument of the Respondent that in the event of Section 22 being applicable the Respondent should have the right to elect under Section 26 (b) for assessment of its joint venture profits under Section 14 and not under Section 22. He said that neither party had contended before him that there was such a right to elect and that he saw no reason to differ from the decision of the Board of Review on this question.

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p. 31 1. 49
p. 32 1. 15

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pp. 32-34.

Scholes, J., then considered the other question asked in the case stated, namely whether

or not the Board of Review was right in its decision that a corporation is not chargeable to tax under Section 22 of the Ordinance. He said that it followed from the clear plain meaning of the relevant words in Sections 2 and 22 of the Ordinance that the profits in question in this case were assessable under Section 22. It was equally clear that, but for the provisions of Section 26 (b) of the Ordinance, the Respondent's profits derived from the joint ventures would also be taxable under Section 14 of the Ordinance, especially in view of the provisions of sub-section (2) of Section 14. The sequence was that upon production of the profits by the joint venture, they became assessable under Section 22; the Respondent's share of such profits would, when received by or credited to it, become assessable under Section 14 but for the provisions of Section 26 (b). The purpose of Section 26 (b) was to prevent double taxation and it operated in this case to prevent the Respondent from being taxed a second time under Section 14.

p. 33 11. 1-4.

p. 33 11. 5-10.

p. 33 11. 10-20.

p. 33 11. 20-25.

Scholes, J., said that the remaining question was whether or not the hardship which would flow in this and other cases from giving the plain meaning to the relevant words in the relevant sections amounted to an absurdity so great as to convince the Court that the intention could not have been to use words in their ordinary meaning. He held that there was here no absurdity and that the Board of review had been mistaken in deciding that a corporation is not chargeable to tax under Section 22 of the Ordinance.

p. 53 11. 34-40.

p. 34 1. 30.

10. The Respondent appealed to the Full Court of the Supreme Court of Hong Kong against the judgment of Scholes, J. The appeal was heard (Hogan, P., Reece and Gregg, A.JJ.) on the 24th and 28th October 1958 and on the 24th December 1958 the Court delivered judgment sustaining the decisions of Scholes J. upon the two questions of law set out by the Board of Review in the case stated but remitting the case to the Board of Review with the opinion that the Respondent was nevertheless entitled to set off against its share of the taxable profits assessed under

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Section 22 of the Ordinance the losses incurred by it in its other trading.

p. 37 1. 33.

p. 38 11.
12-36.

The Full Court considered first whether or not Section 22 of the Ordinance applied to a corporation. The Court referred to the definitions of the words "person" and "body of persons" in Section 2 of the Ordinance and said that despite these definitions the Board of Review held that the word "person" in Section 22 did not include a corporation. The Court said that the Board reached this conclusion mainly because of the view expressed by Mr. Hastie arguing on behalf of the Crown that if a corporation had made a profit on three joint ventures and a loss on another two, it would have to pay on the profits made by the three ventures and could not set off the losses on the other two. Although the Board had not expressed an opinion on the validity of Mr. Hastie's conclusions, it seemed to the Court that both for the purpose of weighing the reasons given for the Board's decision and the arguments addressed to the Court by counsel on the questions contained in the case stated, it was necessary to examine that conclusion somewhat more closely.

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p. 38 1. 40 -
p. 39 1. 37.

The Full Court then proceeded to consider whether a corporation liable to tax under Section 22 for profits made in a joint venture could reduce those profits by losses incurred either in another joint venture or in activities carried on solely on its own account. The Court referred to the provisions of Section 19 (1) of the Ordinance and said that a corporation wishing to reduce its profits by set-off must show that the person making the profit was the same person that suffered the loss. The argument to the contrary was that sub-section (1) of Section 22 created a new taxable entity separate and distinct from a corporation jointly assessed thereunder and the only words in the sub-section which appeared capable of being construed as creating a separate taxable entity were those which said that the assessable profits of the joint undertaking "shall be computed in one sum and tax in respect thereof shall be charged in the partnership name."

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p. 39 1. 38-
p. 41 1. 38.

The Full Court considered the difference between the wording of Sections 14 and 15 of the

Ordinance as to tax being charged "on" corporations and persons and the wording of sub-section (1) of Section 22 as to tax being charged "in" the partnership name. The Court considered that if this difference in language could be regarded as equivalent to saying that the tax should be charged on the partners in the name of the partnership, then the suggestion that Section 22 created a taxable entity separate from the component partners seemed less tenable than if it had said that the tax should be charged on the partnership.

The Full Court observed that Section 22 (1) of the Ordinance appeared to be derived from Section 144 (1) of the English Income Tax Act 1952 although the phrase "shall be separate and distinct from any other tax chargeable on those persons or any of them" appeared in the English partnership tax was made a joint and several liability in Hong Kong but not in England. The Court therefore considered the decisions of the House of Lords in R. v. Income Tax Commissioners ex parte Gibbs (1942) A.C. 402; 24 Tax Cases 221 and of the Court of Appeal in Worth v. Inland Revenue Commissioners (1953) 1 W.L.R. 584; 34 Tax Cases 535 and held that the latter case indicated the limitations which were to be placed upon the scope of the former decision and supported the view that in the present appeal there was a sufficient common identity between the partnership which made profits in the joint venture and the component partner who made losses elsewhere to permit those losses to be set off under Section 19 of the Ordinance. Further, there was the consideration that partners in Hong Kong were severally liable for the whole of the tax on the partnership profits. Thus it was not the partnership profits that were to be deemed to be the separate property of each partner but the tax on them that is made the subject of the separate obligation imposed on each partner. Section 19 provided for a loss incurred by a person chargeable to tax under Part IV to be set off against what would otherwise have been the assessable profits. So it was the chargeability to tax that attracted the set off and the partner's liability having thus been equated with that of the partnership, a clear

p. 41 1. 39 -
p. 53 1. 26.

p. 49 1. 14.

p. 52 11. 6 -
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p. 53 11. 1 -
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p. 53 11. 5 -
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channel for set off seemed to have been established.

p. 54 11. 42-46.

p. 55 11. 29-36.

p. 55 1. 37 -
p. 56 1. 8.

The Full Court considered that neither Section 144 in England nor Section 22 in Hong Kong imposed a liability on something separate and distinct from the component partners. The Court was of opinion that, whilst Section 22 made each partner liable for the whole of the tax on the partnership it was not intended to, and did not, prevent the partners, whether individuals or corporations, from setting off against their taxable profits the losses mentioned in Section 19. It followed that the Appellant was wrong when, in reliance on Section 26 (b), he disallowed the Respondent's losses in the present instance. This was the real point at issue between the parties and it had been very fully argued by counsel before the Court.

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p. 56
p. 56 11. 22-38.

The Full Court then dealt with the two questions of law raised in the case stated. As to the first, the Judge in the Court below had properly applied the canons of interpretation to Section 22 and having regard to the definitions of "persons" and "bodies of persons" given in Section 2 of the Ordinance and to the context in which the word "person" was used in Section 22 (1), he was right in holding that the word "person" in that sub-section included a corporation. As to the second question, the Court agreed that there was no right of election open to the taxpayer under Section 26 (b).

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p. 56 11. 38-45.

11. Although the point of law as to set off of losses upon which the Full Court decided this appeal was mentioned during the course of the hearing before the Full Court, the Appellant respectfully dissents from the statements in the judgment that this question was very fully argued. In the submission of the Appellant it is clear from the transcript of the shorthand notes of the proceedings, in which only two brief references to the point appear, that such discussion of this question as occurred was no more than incidental to the issue as to the application of Section 22 to a corporation. In particular, the case of Worth v. Inland Revenue

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Commissioners, (1953) 1 W.L.R. 584; 34 Tax Cases 535 upon which the Full Court appears to have placed considerable reliance, was not mentioned in the course of the hearing. The Appellant conceives that it would be open to him to submit that the decision of the Court ought to have been confined to the questions of law raised in the case stated. It would, however greatly inconvenience the administration of the Inland Revenue Ordinance of Hong Kong if the opinion of the Court upon this question had to prevail until such time as a fresh appeal could be brought to Her Majesty in Council. The Appellant therefore craves that the validity of the Full Court's decision upon the point may be considered during the determination of this appeal in addition to the two questions of law set out in the case stated.

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12. The Appellant respectfully submits that the Full Court was wrong in deciding that if Section 22 of the Ordinance applied to the Respondent it could nevertheless set off against its share of the joint venture profits its losses from business other than that of the joint ventures. It is submitted that the parties to the joint ventures are assessable to business profits tax as a distinct "person" charged under Section 15 of the Ordinance because the definition of "person" in Section 2 of the Ordinance includes a partnership and not because, as the Full Court considered, the definition of "person" in Section 2 includes a body of persons. The taxable entity here in question is not created by the wording of Section 22 but by the wording of Section 15 in conjunction with the definition of "person" in Section 2. The Appellant also submits that an assessment made under Section 22 must relate to business profits tax chargeable under Section 15 and cannot relate to corporation profits tax chargeable under Section 14, that the "person" so charged is distinct from any corporate partner and that such a corporate partner does not derive from the partnership any "assessable profits" against which losses can be set off under the provisions of Section 19. The Appellant further submits that the scheme of the Inland Revenue Ordinance of Hong Kong in regard to set off of losses in relation to partnership profits is wholly different from that of the British Income Tax Acts in the same regard and that the conclusions

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derived by the Full Court from decisions of the English Courts are mistaken because the questions which fell to be determined in those cases as a matter of inference from the wording of the British legislation are expressly dealt with in the Inland Revenue Ordinance of Hong Kong.

13. By an order dated the 3rd March 1959 the Full Court granted final leave to the Appellant to appeal to Her Majesty in Council from the judgment of that Court. As the Full Court was informed, when application was made for conditional leave to appeal, the Appellant has undertaken to pay the Respondent's costs of and in connection with this appeal up to an amount equal to whichever is the greater of the Respondent's costs on a solicitor and client basis and the amount of the Appellant's own costs. 10

14. The Appellant humbly submits that the decision of the Full Court of the Supreme Court of Hong Kong is wrong and should be reversed insofar as it is adverse to the Appellant and that this appeal should be allowed for the following among other 20

R E A S O N S

- (1) BECAUSE the assessments in dispute were properly made under Section 22 of the Inland Revenue Ordinance of Hong Kong.
- (2) BECAUSE by virtue of the definition of "person" in Section 2 of the Ordinance and of the provisions of Section 15 of the Ordinance the profits of the joint ventures here under consideration are properly chargeable to business profits tax. 30
- (3) BECAUSE by virtue of the provisions of Section 26 (b) of the Ordinance the Respondent is not chargeable to corporation profits tax.
- (4) BECAUSE, if the Respondent is assessable to tax under Section 22 of the Ordinance, the Respondent is not entitled to set off against its share of the profits accruing from the said joint ventures any part of 40

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the Respondent's losses incurred otherwise than in the course of the joint ventures.

- (5) BECAUSE the decision of Scholes, J. was right.
- (6) BECAUSE the decision of the Full Court of the Supreme Court of Hong Kong was wrong in deciding that even though the profits of the joint ventures were assessable under Section 22 of the Ordinance the Respondent was nevertheless entitled to set off against its share of such profits its losses incurred otherwise than in the course of the joint ventures.

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F. HEYWORTH TALBOT.

RODERICK WATSON.

No. 35 of 1959

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B E T W E E N :-

THE COMMISSIONER OF
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- and -

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LIMITED Respondent

CASE FOR THE APPELLANT

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