Case No. D6/84

Board of Review:

H. F. G. Hobson, *Chairman*; A.C. Hill & K. W. Young, *Members.*

19 June 1984.

Profits tax—partnership profits—set off of trading losses sustained by partners outside the partnership—election for Personal Assessment—section 42 of the Inland Revenue Ordinance.

The appellant, as a sole proprietor, sustained certain losses from dealing in shares for the years 1973/74, 1974/75 and 1975/76. The appellant also engaged in property dealing as a partner in two joint ventures which made taxable profits in 1977/78. The 1977/78 Personal Assessment on the appellant took no account of the earlier losses. The appellant appealed on the grounds that the losses should have been set off against his share of the partnership profits.

Held:

(1) Prior to 1975/76 the losses could only be set off against sole proprietorship profits.
(2) After 1974/75 the losses could only be set off against share dealing profits.
(3) The loss for 1975/76 could only be carried forward under section 42(5) if the appellant had elected for Personal Assessment for 1975/76.

Appeal dismissed.

So Chau-chuen for the Commissioner of Inland Revenue.
A. P. Fahy of A. P. Fahy & Co. for the appellant.

Reasons:

1. Prior to 31 March 1976 the Taxpayer, as a sole proprietor, had unsuccessfully dealt in shares, sustaining losses the unrelieved extent of which were $152,145 for the tax year 1973/74, $374,470 for 1974/75 and $62,878 for 1975/76. These activities being the subject of IRD file reference 43/3296.

2. Since 1 April 1962 the Taxpayer had also carried on, as a sole proprietor, the business of buying and selling properties: these activities being the subject of a separate IRD file, namely reference 40/4095.

3. Evidently between 1 April 1973 and 31 March 1978 the Taxpayer did not engage in any property dealings in his personal capacity i.e. as a sole proprietor.

4. However the Taxpayer did engage in property dealings as a partner in two joint venture, in the one instance with two other partners (A and B) in which his share was one third and in the other instance with one other partner (A) in which his interest was a half. Both these ventures were fruitful and generated profits which were assessable for tax in the year ended 31 March 1978. The Taxpayer's share of these profits was $441,002.

5. Not unnaturally the Taxpayer wished to set off his early losses against these profits and his tax representatives Messrs. K. L. Yeung & Co., lodged a notice of objection on the 5th of September 1979, against a Personal Assessment for the year 1977/78 in relation to the Taxpayer's said profit share of $441,002 because it did not take account of the losses referred to in paragraph 1 above. Mr. A. H. Fahy appeared for the Taxpayer at the hearing.

The question before us was, should such losses be set off or taken into account in the 1977/78 Personal Assessment? (If the answer is in the affirmative then the Taxpayer would have no assessable income for the year 1977/78.)

6. This central question gives rise to an examination of the applicable law of set-off for the relevant periods and of the Taxpayer's right to and effect of a Personal Assessment. Mr. So Chau-chuen (Assessor, Appeals) suggested that such examination be divided into pre and post April 1975 periods since Taxpayer had losses in both.

Thus so far as set off is concerned, pre 31 March 1975 losses are dealt with under section 19(1) of the Inland Revenue Ordinance (IRO)—thereby embracing the Taxpayer's property trading losses of $152,145 for 1973/74 and $374,470 for 1974/75, together totaling $526,615—whereas section 19C applies to losses arising after that date, which in this instance cover the $62,878 property trading losses for the year 1975/76.

7. Sections 41 to 43A are concerned with Personal Assessments—an election for which enables a taxpayer to aggregate his separate assessable sources of income and by applying certain deductions to that aggregate he may, if the circumstances are favourable, achieve a lesser total tax than the sum of the tax upon the separate sources of income.

8. Prior to 31 March 1975 section 15A, which was repealed effective on that date, an individual assessable under Part IV of the IRO to business profits tax, was entitled to set his losses in one trade against profits in the same year of assessment in other separate trades in which he had a controlling interest (i.e. more than 50 p.c. if a partnership). If therefore the Taxpayer had had property dealing profits, either as an individual or as a controlling partner, in the tax years 1973/74 and 1974/75 this section would have entitled him to set the losses he suffered in those year (respectively $152,145 and $374,470) against such profits. No such profits were made and section 15A had been repealed; we touch on it because it was referred to at the hearing, and a reference appears in the Assessor's Note to a printed letter, dated 19 June 1978, accompanying the Assessor's loss computation for 1974/75 viz:—

> "As it is not considered that you own the ultimate controlling interest in the partnership business of T and S in Joint Venture, aggregation under section 15A is, therefore, inapplicable."

The joint venture referred to is neither of those referred to in paragraph 4 above.

We are satisfied that in the circumstances section 15A did not and does not offer any assistance to the Taxpayer for aggregation even of the 1973/74 and 1974/75 losses against the 1977/78 assessable profits of the two partnerships because not only do they self-evidently fall in a different year of assessment but also the Taxpayer did not control more than 50 p.c. of either partnership.

9. We therefore now turn to section 19(1) and the Taxpayer's pre 31 March 1975 losses amounting to $526,615. We accept Mr. So's reasoning that section 19(1) does not permit these to be set against the taxable profits of the two partnerships. In our views the words "where a loss is incurred … by a person … such loss … shall be … set off … against … profits of such person …" confine the losses to the same taxable entity—be that entity an individual, a corporation, a partnership etc. (as defined in section 2(1)—that made the taxable profits. Mr. E drew our attention to the Privy Council decision in **CIR v. The Four Seas Company Ltd.** (HKTC 41) and notwithstanding that it is concerned with a corporation taxpayer it is our opinion that the same ratio decidendi applies, namely that as section 22 contemplates the taxation of a partnership as a distinct taxable entity, the losses of a partner acting outside the scope of his partnership cannot under section 19(1) be set off against the partnership profits.

In our view therefore on this particular aspect the Taxpayer must lose.

10. As regards the Taxpayer's post 1 April 1975 share dealing loss of $62,878, sustained in 1975/76, section 19C(1) in effect only allows such loss to be set off against share dealing profits. Strictly speaking this remark is beyond the ambit of the issues raised by the Notice of Appeal dated 28 July 1982 filed by K. L. Yeung & Co. since that notice limited itself to the losses of $526,615, i.e. years 1973/74 and 1974/75. Nonetheless we mention it for two reasons. First because Mr. So dealt with it, presumably by way of rounding off the IRD's attitude to all the share dealing losses, and Mr. Fahy argued that share dealing and property tradings were the same trade, an argument which, purely on common sense grounds, we do not believe can be sustained: the nature of the two activities being so dissimilar as to give rise to two distinct professions, namely share brokers and estate agents. Our second reason for doing so is the bearing it has on the Personal Assessment issue referred to below.

11. The set-off may be summarized as follows:—

No set-off is possible for sole proprietorship share dealing losses incurred by the Taxpayer,

(*a*) prior to 31 March 1975 because under section 19(1) they can only be set against sole proprietorship profits, and

(*b*) after 1 April 1975 because under section 19C(1) they can only be set against share dealing profits.

12. The outstanding matter therefore is the ability of the Taxpayer to elect for Personal Assessment treatment. Here we were confronted with some confusion.

In respect to the tax year 1975/76 the Deputy Commissioner of Inland Revenue found as a fact that the Taxpayer had not made any election for Personal Assessment, Mr. Fahy however maintained that the Taxpayer had done so. We were shown two tax returns both applicable to 1975/76, the one dated 16 November 1976 concerning file No. 40/4095 (i.e. the property dealing file though the Return mentioned also share dealings) in which the Taxpayer said he did not wish for Personal Assessment, and the other dated 2 February 1978 concerning file No. 43/3296, i.e. the share dealing file, in which a Personal Assessment was desired. We were advised by Mr. E that when a return indicates a wish for Personal Assessment the IRD practice is to send the Taxpayer form IR 76, a simple form concerned with the basic residence qualification for Personal Assessment, and form IR 55 wherein the taxpayer sets out the various income which he wishes to be aggregated—this form must be returned within one month.

13. The IRD, presumably in response to the 2nd of February 1978 return (i.e. 1975/76 share dealings losses), made the Computation dated 19 June 1978 referred to in paragraph 8 above, showing losses carried forward of $589,493 which was sent to the Taxpayer and at the same time forms 76 and 55 were enclosed perhaps because the Assessor was unsure whether the Taxpayer wanted to elect for Personal Assessment. In the event neither form was returned to the IRD.

Had the Taxpayer elected for Personal Assessment for 1975/76 then the provisions of section 42(2) would apply:—

> "There shall be deducted from the total income of an individual for any year of assessment—
>
> (*b*) the amount of that individual's loss *or share of loss* for *that year* of assessment computed in accordance with Part IV." (i.e. Profits tax).

The Taxpayer of course had no assessable income in 1975/76, only the $62,878 loss referred to in paragraph 1 above.

Nevertheless, so the IRD argued, if he had elected then section 42(5) would have come into play:—

> "Where in any year of assessment the amount of an individual's loss under subsection (2)(*b*) exceeds the individual's total income … the amount of such excess shall be carried forward and set off against the individual's total income for future year's of assessment."

In other words the carry forward effect of section 42(5) is dependent upon the operation of section 42(2) and with this we are bound to agree.

14. The IRD therefore argues that in order for the Taxpayer to be able to bring his 1975/76 losses forward for Personal Assessment for the year 1977/78, in which he shared in assessable profits, the Taxpayer must as a prerequisite have made an election in 1975/76. This has a curious effect for a taxpayer who, as in this case, had no assessable imcome in 1975/76, in as much as it is incumbent upon him to submit a nil return failing which he is unable to bring his losses into the computation of his Personal Assessment for any future income. Mr. Fahy in his written submission said the Taxpayer "could not make any election that year because he had a loss of $62,878" but on finding that his file disclosed that by the return of 2 February 1978 the Taxpayer had evinced a desire for Personal Assessment we took him to be suggesting that that should suffice for the purpose of section 41(3). We cannot however ignore the fact that on the 19th of June 1978 the IRD did send the Taxpayer forms 76 and 55 and that they were not returned in due time and we therefore conclude that no election was then properly made.

15. We now come to the Personal Assessment for which the Taxpayer admittedly elected for the year 1977/78, the effect of which was to hive off the Taxpayer's share of the partnership profits. Mr. Fahy said that it was unwise of the Taxpayer to make such an election because the Taxpayer's share of tax on the partnership would be less than that under a Personal Assessment. Having reached the view that section 42(5) is dependent upon a Personal Assessment for 1975/76 we accept that there was no point in the Taxpayer seeking Personal Assessment for 1977/78 particularly as the profits involved far overreached the figure up to which the benefits of a Personal Assessment could accrue.

However we were shown no evidence to indicate a greater tax burden. Mr. Fahy also mentioned the practice of the IRD in making computations for the benefit of taxpayers wherein non personal assessment tax and personal assessment tax positions are compared. That may be so and may not have been adhered to in this case, however we do note that the Taxpayer appears to have had professional advice for the years with which we have been concerned—but in any event departure from such an extra legislative practice would not constitute grounds for upsetting the Deputy Commissioner's Determination.

16. Accordingly we hold that this appeal fails.

17. We should mention that we have treated this appeal under section 66(1) as an appeal against the Deputy Commissioner's Determination in relation to the Personal Assessment for the year 1977/78. Messrs. K. L. Yeung & Co.'s letter of 28 July 1982 purports to embrace the three years 1973/74, 1974/75 and 1975/76 notwithstanding that, as appears in

the said Determination it was made in response to Messrs. K. L. Yeung & Co.'s objection against the 1977/78 assessment. If an appeal had embraced 1975/76 then by virtue of the combined effect of section 70 and 41(3) perhaps it would have been open to the Taxpayer to remedy the situation referred to in paragraph 14—however that is gratuitous speculation on our part.