

**A guide to Profits Tax  
for unincorporated businesses (3)**

**Commonly asked questions  
concerning partnership businesses**

## Foreword

This guide is intended to explain, by means of simple questions and answers, some of the Profits Tax obligations that apply in relation to businesses that are operated as partnerships.

To keep it simple and easy to understand, this leaflet does not touch on the question of source of profits.

To know more about the tax rules, you have to refer to the Inland Revenue Ordinance (“IRO”) (Chapter 112) and its subsidiary legislations.

## Common questions and answers

**Q1 I started a partnership business with my brother and our first accounts closed on 31 March 2012. How should I report my share of the profits of the partnership to the Inland Revenue Department (“IRD”)?**

- Answer
- ◆ For Profits Tax purposes, a partnership is treated as a separate legal “person”. The assessable profits of a partnership are calculated in a single amount and the tax in respect of the profits is charged in the name of the partnership.
  - ◆ The precedent partner<sup>1</sup> of the partnership should complete for the partnership a “Profits Tax Return – Persons Other Than Corporations” (BIR52) for the year of assessment 2011/12.
  - ◆ The IRD normally issues the first profits tax return some 18 months after the date of commencement of a new business. If you have assessable profits for the year of assessment 2011/12 and have to pay Profits Tax for that year, you should write to inform the Commissioner and ask for a tax return for completion. Your notification in this respect must reach the IRD by 31 July 2012.
  - ◆ The “net profits” shown in the accounts of the business have to be converted into its “assessable profits” and declared in BIR52.

---

<sup>1</sup> Section 2 of IRO has a definition of “precedent partner” for tax purpose.

- ◆ Reference can be made to another pamphlet in this series entitled “A guide to Profits Tax for unincorporated businesses (1)” [PAM 56(e)] for guidance on how to convert the accounting profits of a business into its assessable profits.
- ◆ Normally, a Profits Tax Assessment would be raised on the partnership at the standard rate. However, if Personal Assessment is elected, the partners’ tax liabilities may be reduced.
- ◆ Where it is apparent that a partner will obtain a tax advantage by electing Personal Assessment, Profits Tax and Provisional Profits tax are not, in practice, charged on his/her share of assessable profits from the partnership. Tax on such partner’s share of assessable profits will be separately charged under his/her Personal Assessment.
- ◆ The IRD leaflet entitled “A Brief Guide to Personal Assessment” [PAM 37(e)] contains further information on the subject.

**Q2 Under the partnership agreement, I draw a monthly salary of \$10,000 from the business and the balance of the profits is divided between the two of us in equal shares. How will the assessable profits of the business be allocated between us?**

Answer ◆ The allocation of the assessable profits (or adjusted loss) between partners takes into account any salary or interest on loan or capital invested which has been paid to a partner or his/her spouse. Such a payment is treated as if it were a distribution of profits to the partner concerned and the balance of the assessable profits is then apportioned on the basis of the agreed profit sharing ratio. The following examples illustrate how this is done:–

***Example 1***

	\$
Assessable profits	300,000
Less: Emoluments paid to Partner A	<u>120,000</u>
Remaining balance	<u><u>180,000</u></u>

Allocation of Assessable Profits	Partner A	Partner B
	\$	\$
Emoluments	120,000	---
Sharing ratio	50%	50%
Share of balance	<u>90,000</u>	<u>90,000</u>
Share of assessable profits	<u>210,000</u>	<u>90,000</u>

**Example 2**

	\$
Assessable profits	100,000
Less: Emoluments paid to Partner A	<u>120,000</u>
Remaining balance	<u>(20,000)</u>

Allocation of Assessable Profits	Partner A	Partner B
	\$	\$
Emoluments	120,000	---
Sharing ratio	50%	50%
Share of balance	<u>(10,000)</u>	<u>(10,000)</u>
Sub-total	110,000	(10,000)
Reallocation	<u>(10,000)</u>	<u>10,000</u>
Share of assessable profits	<u>100,000</u>	<u>---</u>

- ◆ As the partnership in Example 2 was in a profitable position overall (i.e. it had assessable profits of \$100,000), no partner could be allocated any loss. Hence, the notional loss was re-allocated to the partner who was in a “profit position” after the initial allocation.

**Q3 Do I need to report the salary I receive as a partner in the same manner that an employee would report a salary, i.e. in a “Tax Return – Individuals” (BIR60)?**

Answer No. You do not have to report the salary you draw from the partnership business in a BIR60 as the amount will be included in the assessable profits of the business.

**Q4 I expressed a wish to elect for Personal Assessment in the Profits Tax Return completed in respect of the partnership, yet Profits Tax was still charged in respect of my share of the assessable profits of the partnership. Why was this the case?**

- Answer
- ◆ One possible explanation is that it was not to your advantage to elect for Personal Assessment. Profits Tax would still be levied on the partnership in respect of your share of its assessable profits if the total tax payable under Personal Assessment on the aggregate of your income and that of your spouse was greater than the total tax payable on your respective incomes under the separate direct taxes, i.e. Profits Tax, Salaries Tax and Property Tax.
  - ◆ The other possibility is that you did not complete or properly complete the relevant section in the “Tax Return – Individuals” (BIR60) issued for the same year of assessment. That affected our processing of your election. If you want to put right your election for Personal Assessment, you should contact the Assessor handling your “Tax Return – Individuals” (BIR60) by quoting your file reference.

**Q5 Our partnership business had an assessed loss in the previous year of assessment and one of the partners, who is an individual, retired at the end of that year. In this regard, can the share of the loss allocated to the partner who retired be used to set off the profits of the partnership of this year and subsequent years?**

- Answer
- Where an individual incurs a share of a loss in a business carried on by a partnership and does not elect for personal assessment for that year of assessment, the amount may be carried forward and set off against his/her share of assessable profits from the partnership business in subsequent years of assessment until it is fully set off. However, the remaining balance of the loss of a partner would lapse if the partner retires before the loss is fully set off, i.e. the balance cannot be utilized to reduce the subsequent profits of the partnership.

**Q6 Is there any need to inform the Business Registration Office about the retirement of a partner?**

Answer Yes. You are required to advise the Business Registration Office of any admission or retirement of partners within 1 month of such change. You may use a Form IRBR64, which can be obtained from our office or downloaded from our web site, for this purpose.

**Q7 I used to run a taxi business on my own and closed my accounts on 31 March each year. On 1 September 2011 I admitted my brother as a partner to the business and after that day, the profits were shared equally. Do I need to cancel the old business registration certificate and obtain a new one? And how will the assessable profits of the business be computed for the year 2011/12?**

- Answer
- ◆ You do not need to cancel the original business registration certificate. You only have to inform the Business Registration Office of the admission of a new partner, using a Form IRBR64.
  - ◆ If your business changed from a sole proprietorship to a partnership during the year of assessment 2011/12, you should report the profits/(loss) of the business for the full basis period of the year of change in the Profits Tax Return (BIR52) for the partnership instead of in the Tax Return – Individuals (BIR60) issued to you.
  - ◆ As for the computation of the Profits Tax liability of the business for 2011/12, the tax payable for the year would be based on the assessable profits of the business for the whole year, calculated without regard to the change in ownership. In other words, the admittance of your brother would not have any effect on the computation of the assessable profits, although of course it would have a bearing on the allocation of profits between the two of you.

***Example***

	\$
Gross receipts (1.4.2011 – 31.8.2011)	180,000
Gross receipts (1.9.2011 – 31.3.2012)	<u>340,000</u>
Total gross receipts	520,000
Less: Deductible expenses (1.4.2011 – 31.3.2012)	<u>220,000</u>
Assessable profits for 2011/12	<u>300,000</u>

Allocation of Assessable Profits	You	Your brother
	\$	\$
Assessable profits 1.4.2011 to 31.8.2011 (\$300,000x5/12)	125,000	---
Assessable profits 1.9.2011 to 31.3.2012 (\$300,000x7/12)	87,500	87,500
Share of assessable profits	<u>212,500</u>	<u>87,500</u>

**Q8 I am a partner, but not the precedent partner, of a business. Do I have any liability to file a Profits Tax Return in respect of the business if the precedent partner cannot be located and has taken away the books of account of the business?**

**Answer** Yes. All partners of a partnership are jointly and severally liable for the liabilities of the partnership. You are therefore liable, as a partner of the business, to take up the filing responsibilities of the business. Even if you do not have a complete set of records, you are still required to prepare accounts on the basis of the incomplete records available and whatever other relevant information you can obtain. You are also liable to pay any outstanding Profits Tax liability of the business, notwithstanding that such an amount may relate to your partner's share of the profits of the business.

## Further Information and Assistance

You may

- (a) visit our web site at [www.ird.gov.hk](http://www.ird.gov.hk);
- (b) telephone 187 8088; or
- (c) read related leaflets [PAM 56\(e\)](#) and [PAM 57\(e\)](#) on "A guide to Profits Tax for unincorporated businesses (1) and (2)".

(The contents of this leaflet are for guidance only)

PAM 58(e)  
July 2012