

INCOME-TAX REFERENCE.

Before Sir Arthur Page, Kt., Chief Justice, Mr. Justice Das and Mr. Justice Mya Bu.

1933

July 10.

IN RE THE COMMISSIONER OF INCOME-TAX,
BURMA

v.

K.A.R.K. FIRM.*

Income-tax—Trading loss—Land taken over in lieu of debt—Practice of Income-tax authorities—Valuation of assets on reconstitution of assessee firm—Estimated depreciation in value of land—Income-tax Act (XI of 1922), s. 26.

A Chetty firm of money-lenders took in a new partner, and on that occasion a valuation was made of the stock and property forming the assets of the old firm. The assets were in part immovable property received from debtors of the firm in the ordinary course of business. The firm was assessed under s. 26 of the Income-tax Act, and the assessee claimed to deduct from their trading profits in the accounting year a sum of Rs. 34,561 as being a trading loss. This sum represented the estimated loss of the capital value of the immovable property appearing from the valuation. The practice of the Income-tax authorities where property received in repayment of a loan is sold during the accounting year at a price less than the loan, is to allow the difference as a trading loss.

Held, that in the circumstances of the case the sum was not a trading loss, but was only the estimated depreciation of the value of the assets of the firm based upon a revaluation of such assets made for the purpose and on the occasion of the reconstitution of the firm.

A. Eggar (Government Advocate) for the Crown.
It is not necessary for the purpose of deciding this reference to consider the question whether the introduction of a new partner into a firm *ipso facto* constitutes it a new firm. The Income-tax Act is not concerned with the niceties of partnership law; and for the purposes of taxation the Act treats the firm as a convenient unit. S. 42 of the Partnership Act, which recapitulates the old law on the subject, is silent on the point whether the introduction of a new partner dissolves the old firm, though,

* Civil Reference No. 10 of 1933.

logically, speaking, it ought to have said so when, in fact, it states that the death of a partner dissolves it; see, however, s. 17 of that Act which deals with the rights and liabilities of a partner when there is a change in the constitution of a firm.

The present case falls under s. 26 of the Income-tax Act. The business of the old firm was continued by the new firm, the only change being that there was an additional partner. The newly constituted firm is the assessee, and is assessable for the previous year as though it were carrying on business in that year. The loss of value on the lands sought to be deducted from profits is only a loss of capital, and not of revenue.

N. M. Cowasjee (with him *Daniel*) for the assessee. Lands made over to the assessee in satisfaction of debts owed to him by his debtors were estimated to be less in value than the amount of the loans advanced, and this loss is claimed in the books of account as a trading loss. Chettyar money-lenders do not deal in lands and they are not part of their capital.

[PAGE, C.J. Did all the transactions in respect of the sum in question take place during the accounting year?]

The sum in question is shown in the books of account as a trading loss in the year of assessment, and was shown in the return made to the Income-tax authorities as a bad debt for that year. In determining profits one must take into account all income and expenditure. This item is shown in the books as a loss of income; but the Income-tax authorities disallowed the deduction, and did not take it into account in determining the profits.

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A. Eggar in reply. The assessee firm is merely seeking to revalue assets transferred to it from the old firm. There is no finding by the Income-tax Department as to whether the amount disallowed was loss incurred in the year in question.

The Income-tax Act is defective in many ways. It does not define capital. It recognizes different methods of accounting. On a mercantile basis a revaluation of lands may be made year by year. But the normal system adopted by the assessee is the system based on a cash basis, and the Income-tax authorities may have disallowed the item in question for the reason that under that system such deduction may be claimed in the year when the lands are actually sold. Or it may be that the method adopted by the assessee was not a fair method of accounting, and no such deduction could therefore be claimed.

PAGE, C.J.—In this case the K.A.R.K. Chettyar Firm, carrying on business as money-lenders in Pyu in the Toungoo District, was assessed for the year 1931-32 upon the profits and gains of the firm in the accounting year 1930-31. By a partnership agreement executed on the 16th July 1930 the firm was newly constituted, an additional partner being taken into the firm which previously had consisted of five partners. Thereafter the business was carried on by the six partners, the shares of the new partner being different from the shares of the five partners in the old firm.

The assessment upon the firm and the partners under s. 26 (a) of the Income-tax Act was based on the profits of the business that had been earned during the accounting year. Now, at the time when the firm was reconstituted a valuation of the

assets of the business had been made, but, as was pointed out by the assesseees in a note to the Assistant Commissioner of Income-tax explaining the grounds of the appeal to him from the Income-tax Officer, this was only a valuation of the stock and property forming the assets of the old firm. The old firm possessed *inter alia* immovable property which was acquired by it in the ordinary course of business. This property was let out on lease, and taxable profits in the form of rent accrued therefrom to the assesseees. The assesseees now claim to be entitled to deduct from the trading profits in the accounting year a sum of Rs. 34,561 as being a trading loss. This sum of Rs. 34,561 represents the estimated loss of the capital value of the immovable property under the valuation to which reference has been made.

For the purpose in hand it is immaterial whether the business is treated as having remained the property of the original partnership, or as having been transferred to the new partnership, and we express no opinion upon that question. It must not be taken, however, that as at present advised we should be prepared to differ from the view taken by the Commissioner of Income-tax that the effect of the transaction was that a new firm was constituted.

The sole question that arises in the present reference is whether this sum of Rs. 34,561 was a trading loss realized during the accounting year. It does not purport to be anything of the sort, and the valuation upon which it is based was not made for the purpose of ascertaining the trading loss of the business during the accounting year, but for the purpose of obtaining a revaluation of the assets of the business having regard to the impending

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change in the constitution of the firm. Further, no evidence was adduced in respect of the immovable property which is alleged to have decreased in value to the extent of Rs. 34,561 that there was any realized loss of profit during the accounting year or afterwards. In the assessment order a deduction is allowed for the loss resulting from the sale of a house during the accounting year, and it appears that the practice of the Income-tax authorities in connection with such assessments as that under consideration, where immovable property is received during the accounting year in repayment of a loan by the assessee, is that if during the year the property is sold and the proceeds of the sale are less than the loan the repayment of which they represent the difference is allowed as a trading loss in the business of the assessee. Unless and until property taken in repayment of loans is sold or otherwise disposed of for value there can, of course, be no realized trading loss in respect of such property during the accounting year. In my opinion this sum of Rs. 34,561, in the circumstances disclosed in the present case, was not a trading loss which accrued during the accounting year, but was the estimated depreciation in the value of the assets of the firm based upon a revaluation of such assets made for the purpose, and on the occasion, of the reconstitution of the firm.

For these reasons, in my opinion, the answer to the question propounded is in the negative. Costs ten gold mohurs.

DAS, J.—I agree.

MYA BU, J.—I agree.