

INCOME-TAX ACT REFERENCE.

Before Sir Ernest H. Goodman Roberts, Kt., Chief Justice, Mr. Justice Mya Bu, and Mr. Justice Mosely.

1939

Jan. 13.

IN RE THE COMMISSIONER OF INCOME-TAX,
BURMA

71.

SETH MANGOOMAL LUNIDASINGH.*

Income-tax—Registration of partnership instrument—Shares of partners to be definite and determinable—“Gumashta” partners—Shares solely confined to profits or losses—Difficulty of computing net receipts—Share not net receipts—Shares of partners the basis of computation—Burma Income-tax Act, s. 26A, rules 2 to 6.

Where the Income-tax Officer is satisfied that a partnership is genuine and the shares of each partner, as a basis for computation and not as a means by themselves of calculating his receipts, are definite and determinable, and the instrument of partnership definitely specifies these individual shares, the instrument is registrable under s. 26A of the Burma Income-tax Act, read with rules 2 to 6. The fact that the shares of the “Gumashta” partners of a firm are solely confined to the profits or losses, and what they will actually get depends upon the time which they have devoted to the business, or their absence therefrom, and the fact that there are elements in the partnership instrument which makes it only difficult to compute the net receipts of any partner for any particular year, if the accounting period is not an annual one, are not grounds upon which registration can be refused. The law looks to the shares in the partnership business and not to the receipts from it, which may happen in certain contingencies to find their way into the pockets of individual partners. “Share” does not mean net receipts. The shares are a starting point from which a calculation can be made determining the amount of net profits which are payable, having regard to the provisions of the partnership instrument, to any individual partner. This starting point must be fixed, invariable and clearly stated.

Clark for the assessee. A firm registered under the Income-tax Act enjoys certain privileges. See ss. 14 (2), 48 (2). To be registered under the Act certain formalities have to be complied with as prescribed by s. 26A of the Act and the Rules thereunder. The Commissioner of Income-tax is satisfied in this case that the firm is a genuine one; he has refused to register the firm on the ground that the individual shares of the

* Civil Reference No. 6 of 1938.

partners are not properly set out. A reference to the partnership deed will show that the share of each partner is clearly set out in clause 5 thereof. The Commissioner has been misled into refusing registration because clause 7 of the deed gave power to the *Shah* partner to admit new members into the partnership and under clause 12 a partner may stand to lose a portion of his share of the profits by reason of his absence for a stated period.

There is a confusion between two ideas in the reference. It is not for the income-tax department to concern itself as to what happens to the shares ultimately or whether the individual shares are drawn by the partners or not. Neither the Form prescribed nor the Rules require that the shares should be so divided, whether at the end of the first or second or any other year. In the case of some partnerships the members contribute large sums to charity which naturally reduce their respective shares of the profits, but the income-tax department never gives any allowance for such sums. This shows that in practice the department is not concerned with the actual distribution of the profits. Again the partners may decide to put back part of their profits into the business; this will not and should not affect the question of the assessment of the firm, and where new partners are added under clause 7 a new firm is constituted and other provisions of the Act come into play, and consequently this fact has no bearing on the assessment of the firm for the previous year.

The effect of the words at the foot of the form which certify that the profits will be actually divided in accordance with the shares shown in the deed is merely that the firm is a genuine one and normally this would be the eventual basis of distribution of profits. No business can be carried on if the certificate is rigidly construed. S. 23A of the Act itself shows that

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the profits may not be distributed at all every year in spite of the certificate.

Though the English Act is not *in pari materia* the principle applicable is the same. See *The Commissioners of Inland Revenue v. Blott* (1). It is the proportionate share of the partners that the income-tax department is concerned with, and not the actual receipt of the profits by each partner.

Thein Maung (Advocate General) for the Crown. The advantages of registering a firm are summarised at p. 131 of Sundram's book on Income-tax. These being valuable rights s. 26A and the Rules should be strictly complied with. A partnership may be a genuine one, but registration may still be refused if the individual shares of the partners are not properly specified. Reading the instrument of partnership as a whole and reading clauses 5 and 12 together it is apparent that the shares of the partners are liable to constant variation. The deed must show a definite share which the partner will get whatever the profits may be. In this case, in view of the powers given to the *Shah* partner, even though the profits are known as well as the share of each partner, it will be difficult to ascertain that fraction of the profits which each partner will actually get. The fraction specified in the deed must be constant, and must not be liable to variation at the will of one partner. S. 28 (2) of the Act shows that the distribution of profits must be in accordance with the Instrument of partnership.

There are authorities to show that the income-tax authorities can go behind an instrument of partnership to see whether the partnership is genuine. *Haji Ghulam Rasul-Khuda Bakhsh v. Commissioner of Income-tax, Punjab* (2) ; *Sunder Singh v. Commissioner*

(1) 8 T.C. 111.

(2) I.L.R. 19 Lah. 113.

of *Income-tax* (1). Similarly the income-tax authorities should have the power to go behind the deed to see whether the fractions have been properly specified and whether the certificate given at the end of the form is correct.

As pointed out in *Kanniappa Naicker and Company v. The Commissioner of Income-tax, Madras* (2) strict compliance with the Act is necessary. The Income-tax Officer should not be required to launch upon an inquiry to determine what is the actual share of a partner.

If the Act contemplated any contingency arising by reason of which the shares may become liable to a variation it would have said so either in the certificate or in s. 28 (2).

ROBERTS, C.J.—The following question regarding the respondent assessee has been referred for the determination of the High Court under section 66 (2) of the Burma Income-Tax Act, by the Commissioner of Income Tax :

“Whether the document dated the 17th October 1937 is an instrument of Partnership legally registrable under section 26A of the Act, read with rules 2 to 6?”

Section 26A of the Act runs as follows :

“(1) Application may be made to the Income-tax Officer on behalf of any firm, constituted under an instrument of partnership specifying the individual shares of the partners, for registration for the purposes of this Act and of any other enactment for the time being in force relating to income-tax or super-tax.

(2) The application shall be made by such person or persons, and at such times and shall contain such particulars and shall be in such form, and be verified in such manner, as may be prescribed ; and it shall be dealt with by the Income-tax Officer in such manner as may be prescribed.”

(1) [1938] All. 638, 645.

(2) [1937] Mad. 814, 827.

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Rules 2 to 6 direct the manner in which a firm may apply for registration and the form in which application shall be made is set out. Paragraph 3 runs :

"I/we do hereby certify that the profits of the current year will be actually divided or credited in accordance with the shares shown in the partnership deed."

It has been found as a fact that the document dated the 17th October 1937 is a *bona fide* instrument of Partnership. The Commissioner of Income-Tax in his reference says :

(a) in paragraph 8 of the case stated

"I regard the Deed, not only as a *bona fide* partnership, but as a well thought out, though ill drafted, document comprising a very sensible and practical profit sharing partnership."

(b) in paragraph 10

"I therefore do not consider that this non-division of the profits at the end of the account period on which the assessment is based is in this case an indication that the Partnership is not genuine."

(c) in paragraph 20

"I am disposed to regard it as a genuine partnership containing unusually strict measures against those partners who contribute only their services and derive their interest in the concern therefrom."

(d) in paragraph 21

"I am prepared to admit that the Partnership deed itself is genuine."

Paragraph 5 of the partnership deed of the 17th October 1937 sets out the shares of the partners with great precision. With regard to this matter the Commissioner says (Paragraph 11) :

"The shares of the partners are thus solely confined to the profits or losses, but they are nevertheless definite and

determinable and the Deed definitely specifies these individual shares. The Act does not limit this specification of shares to shares in the capital of the firm. There are, however, in the Deed other provisions, which render the specification of the shares above mentioned inadequate."

He points out that paragraph 12 of the Deed says that what the *Gumashta* partners of the firm actually get will depend upon the time which they have devoted to the business, or their absence therefrom, and he says

"this is a variable contingency, the effect of which could not be determined at any time prior to the closing of the accounts."

Now what is the difficulty which the Commissioner sees? He says that determination of the profits could be upset by reason of clause 7 unless there were a definite settlement of accounts at the end of each year. Clause 7 merely says that the *Shah* partner may increase or decrease the number of *Gumashtas* and allot a share to new partners. When this is done there is an end of the old and a creation of the new partnership, and the new partnership must apply for registration if it desires to enjoy the benefits or privileges accruing therefrom. What we have to consider is the existing partnership; and that alone.

Then he says

"if the Deed were accepted for registration the profits would have to be determined in accordance with the actual shares as primarily set out, disregarding the complicating adjustments for actual business time."

It seems to me that the Commissioner is there dealing not with the proportionate shares of the partners but with the actual receipts made over to them, and therein, in my opinion, a fallacy lies.

A partner may be asked "What is your share of the partnership?" and he may reply two annas six pies or

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whatever it may be, no less because he may have been ill or absent and his receipts may have been reduced by the operation of another clause in the partnership agreement on this account.

To take a detailed instance, supposing **A**, **B** and **C** each have one-third share in a partnership and the total net receipts to amount to Rs. 12,000. The basis of computation is one-third share each namely Rs. 4,000. If **A** is absent for three months he loses Rs. 1,000 because he is away for a quarter of the year and he receives only Rs. 3,000. **B** and **C** receive an augmented sum namely their Rs. 4,000 *plus* half **A**'s unearned receipts which brings each of their total receipts for the year to Rs. 4,500. Nobody could arrive at these figures in the distribution of the receipts without taking the one-third share as a basis for computation before making this necessary deduction and the consequent increases. The learned Advocate General urged that no partnership can be registered if any partner under the deed is liable to have a variation of his share. I agree, but I do not think that "share" means net receipts. In my opinion it is the basis of computation from which, after other necessary factors are considered, you are going to arrive at them.

Looked at in this light the application for a certificate of registration is in no way misleading. The profits of the current year are indeed actually credited in accordance with the shares as shown in the partnership deed. The credit given need not take place in any one year. The Commissioner himself admits that in the circumstances this is no ground for impugning the validity of the Partnership. (See paragraph 10 of the case stated.) The shares as stated are a starting point from which a calculation may be made determining the amount of the net profits which are payable having regard to the remaining provisions of the Partnership

Deed to any individual partner. This starting point is fixed and invariable and clearly stated.

In the case of *M. Kannappa Naicker and Company v. The Commissioner of Income-tax, Madras* (1) cited to us the deed was silent as to the exact shares. The partnership was that of M.K. Naicker & Company and it was not enough to say that two of the partners were M.K. Naicker & Sons and that they received seven annas in the rupee. The precise share of each of them had to be set out. This deed is clear as to the shares, that is to say as to the basis of computation from which the net receipts of each individual partner are to be ascertained.

Though the determination of this question appears to me to be quite clear I have asked myself what would be the effect of the interpretation placed upon it by the learned Advocate General. The registration of large partnership firms with the privilege thereby of avoiding the incidence of supertax has been permitted by the Legislature. No well conducted partnership business would fail to make provision for the absence of a partner either on holiday or through illness and the consequent adjustment of the remuneration due to him. If it does so, according to the argument presented before us, it will be impossible to ascertain the shares of the partners and no application for registration can be entertained.

In practice, provided all the profit of a firm is accounted for, the Income-tax authorities try to assess individuals [see Part III Notes and Instructions paragraph 71 (iii)]. If the whole of the profits of a registered firm exceed the amounts accounted for in the personal statements of the partners, adjustment must be made to ensure that the firm through its partners pays an adequate amount of tax. Nobody could pretend that

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if three partners each had an equal share in the partnership business they must receive $33\frac{1}{3}$ per cent of the net profits apiece, because it may be frequently politic to put income back into the business ; what matters is not the amount received by each partner but the basis of computation from which those receipts are derived. The Commissioner says (in paragraph 12 of the case stated) that absences from business in a second or third year of a settlement period affect the ratio of the distribution of profits in any previous year of the settlement period. He points out that the profits from year to year will be certain to vary. If he thought that this was evidence that anyone were seeking to evade payment of income-tax he would avail himself of the provisions of section 23 and could assess individual partners instead of the firm ; but he agrees that the fact that an account is reached either on change of partners or otherwise about every five years can be understood in this instance, and is no indication that the Partnership is not genuine. Provided he is satisfied that the Partnership is genuine and the shares of each partner (as a basis for computation and not as a means by themselves of calculating his net receipts) are definite and determinable and that the Deed definitely specifies these individual shares, I do not see that there is cause for complaint. In effect it is said that the shares are variable because the receipts of each individual partner may vary having regard to clause 12 of the deed and the effect of this upon the infrequency of accounting. The authorities may always complain provided they can show that in any accounting period the basis for computation has been lost sight of : but that is not what they are doing here. They are seeking to say that the partnership cannot be registered because although the shares (or basis for computation of receipts) of each individual partner are clearly expressed, other provisions

in the Deed may enable the basis to be lost sight of in a proper calculation. In my opinion this partnership having been found to be a *bona fide* partnership and having complied with the provisions of the Act ought to be registered. It may be considered that the partnership deed introduces elements which will make it difficult to compute the net receipts of any partner in accordance thereunder for any particular year, if the accounting period is not to be an annual one. If an accounting period is, let us say, three years, and the net profits for each year vary, I agree that it is difficult to make the proper deduction for one partner's absence, let us say, for three months of the second and one month of the last year. A genuine and *bona fide* deduction must however be made upon such materials as are available. We only have to administer the law and to see that the requirements of the Act are fulfilled, and not that their fulfilment makes the necessary arithmetic or calculation easy. The profits of each current year must be shown and must be credited in accordance with the shares shown in the partnership deed. That is the basis of computation. Not only is it provided in the application for registration that the profits for each current year must be shown at the end of each accounting period, but it is evident that any attempt to make deductions for absence calculated by striking an average over a longer period would lead to inaccuracy.

Supposing for example the accounting period is for three years and three partners each have an equal share in the partnership business. If one of them is absent for six months it will not do to say that he is to receive five-sixths of his one-third share spread over the three years. The time during which he is absent may have occurred during a year of prosperity and he may have to forfeit proportionately more than if it had occurred

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at a time when profits were relatively low. Consequently though accounts may be at any reasonable time having regard to the exigencies of the case a balance must be struck for each current year. In my opinion the law looks to the shares in the partnership business and not to the receipts from it, which may happen in certain contingencies to find their way into the pockets of individual partners.

In *The Commissioners of Inland Revenue v. Blott* (1) Rowlatt J. said :

“ In the case of trading (including professional) partnerships it was enacted by a proviso to the rule already quoted that a partner claiming exemption might declare the proportion of his share and be exempted accordingly. His income for the purposes of exemption was, therefore, his proportion of the collective taxable profits of the partnership. His actual or permissible drawings were wholly irrelevant.”

And again quoting a decision of Horridge J. he remarked that

“ the share of the partner in the collective profits, and not his drawings was still the figure to be looked for.”

These authorities, though dealing with the position according to the English law, reinforce in my mind the conviction that it is a fallacy to say that the individual shares of partners are not “ adequately ” specified by reason of the fact that their drawings, or receipts, may be conditioned by effect being given to other stipulations in the partnership deed.

Accordingly I would answer the question propounded in the affirmative. The Commissioner of Income Tax must pay the costs of this reference, twenty gold mohurs.

MYA BU, J.—I concur.

MOSELY, J.—I concur.