

*Privy Council Appeal No. 5 of 1935.*

The Commissioner of Income Tax, Madras - - - - *Appellant*

*v.*

P. R. A. L. Muthukaruppan Chettiar - - - - *Respondent*

FROM

THE HIGH COURT OF JUDICATURE AT MADRAS.

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JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF  
THE PRIVY COUNCIL, DELIVERED THE 24th MAY, 1935.

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*Present at the hearing :*

LORD ATKIN.

SIR JOHN WALLIS.

SIR SHADI LAL.

[*Delivered by* LORD ATKIN.]

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This is an appeal from the High Court at Madras on a reference under S. 66 of the Indian Income-tax Act, 1922. The question is whether a sum of Rs. 38,305 was a receipt of capital or a receipt of profit assessable under S. 4 (2) of the Income-tax Act. The facts are simple. The respondent is a Chetti carrying on business in Madras where he resides and in various other places within and without British India. He was up to May, 1930, one of three partners in a moneylending business S.P.K.A.A.M. at Colombo in which he had a  $6\frac{3}{4}$  share. On 31st May, 1930, he severed his connection with that firm, and an account was taken of the amounts due to him by way of capital, surplus capital, share of profit and interest thereon: and a sum of Rs. 2,09,670 was found due to him which included Rs. 23,500, share of profits from 26th October, 1926 to 31st May, 1930, and Rs. 38,305 interest on capital. The Rs. 23,500 was paid to him by hundis drawn by the remaining partners and cashed at Colombo. The Rs. 38,305 together with the greater part of the capital sum due was remitted to him in Madras, by the promissory note of a debtor of the firm made out in the respondent's favour. No question of fact arises on the reference which can only raise a question of law. The only question for the Court is whether the sum of Rs. 38,305 received by the respondent in Madras in respect of interest on capital employed in business in Ceylon is assessable under S. 4 (2) of the Income-tax Act. No dispute arises as to the sum being derived from business: the only question is whether the effect of the dissolution was to make payment of all the

sums due on dissolution payments by way of capital and not payments of income or profits. The High Court following a decision of their own in *Commissioner of Income Tax, Madras v. Siddha Gowder & Sons I.L.R. 55, Madras 818 (1932)* held that the principles laid down in the English case of *Inland Revenue Commissioners v. Burrell [1924] : 2 K.B. : 52* governed the case and decided in favour of the respondent. But that case involved what appears to their Lordships quite a different set of facts, the receipt by a shareholder of his share of the assets of a company upon a winding-up. It was pointed out in the judgments of the Court of Appeal that a company is a separate entity to the shareholders : that during the continuance of the company the latter have no right to the profits except so far as they are distributed on a regular declaration of dividend : and that on winding-up their sole right is to share in the assets available after winding-up : and that for the purpose of ascertaining such assets it is quite immaterial whether the company originally possessed them by way of capital or profits. The liquidator may apply sums earned as profits in paying capital liabilities and capital assets in paying revenue liabilities. What he distributes is a lump sum, and no reconstruction into a division of capital and profits is necessary or in many cases possible. The position in respect of a partnership is different. The profits are the profits of the partners, joint in the first instance, and if the appropriate statute so provides assessable as joint : but in fact representing an interest of each partner : and as soon as declared constituting an obligation from the firm to each partner. If the Ceylon ordinance be analogous to the English Act there would be no doubt that up to May, 1930, the respondent would have been assessable to income tax jointly and to surtax severally on the amount of the profits in question. And if in fact instead of being left in Colombo undrawn, the sums in question had before May, 1930, been remitted to the respondent in India no question would have arisen as to his having been assessable under the India Act on those sums. Being profits of the respondent up to 31st May, 1930, how did they alter their character by dissolution? The account taken on dissolution ascertains what is due to the partners for profits, and what is due for capital. It can hardly be suggested that the partners share according to their capital proportions in the whole assets of the partnership. The sum due for undrawn profits was and remains a sum due by the partners to each partner : and necessarily ranks first before the sums due for capital can be distributed. In other words on dissolution of a partnership an outgoing partner has the right to receive not as in the case of a shareholder in winding up a company only a share of the assets : but to receive payment of his profits, profits which were his before dissolution and do not cease to be his on dissolution. In their Lordships' opinion the respondent received this payment in India as a payment of profits and was properly assessed. Counsel for the respondent pointed out that the contention of the Commissioner in this case was the contrary of that made by him in the previous

case in Madras which was successful in the High Court. He protested strongly against the Commissioner in successive cases blowing hot and cold. But that is a privilege not confined to Commissioners of Income Tax and its exercise cannot influence judicial determination of the law. Their Lordships think it desirable to point out that their decision does not cover cases where undrawn profits have with the consent of all parties been invested in the business so as to increase the capital account, a position which does not arise here. Nor have they had to consider any special provisions of partnership articles which might affect the matter : for there were none in this case. For the reasons given they are of opinion that this appeal should be allowed : the order of the High Court dated the 27th April, 1934, should be set aside and the question referred to the Court by the Commissioner should be answered that the sum of Rs. 38,305 is a receipt of profits assessable under S. 4 (2) of the Income-tax Act. The respondent must pay the costs here and in the High Court.

Their Lordships will so humbly advise His Majesty.

In the Privy Council.

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THE COMMISSIONER OF INCOME  
TAX, MADRAS

v.

P. R. A. L. MUTHUKARUPPAN  
CHETTIAR

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DELIVERED BY LORD ATKIN.

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