PHILIP RICE *v*. THE COMMISSIONER OF INLAND REVENUE

[Appellate Jurisdiction (Carew, P.J.) October 13th, 1950]

Income Tax—partnership—money set aside for passages for partners—loss of money by burglary—whether deductible amounts.

The appellant was a partner with Kenneth Albert Stewart in a firm of solicitors and barristers. A certain portion of the profits of the partnership was set aside to form a Passage Reserve Fund, a fund to be spent on passage by sea so that either of the partners could take regular holidays out of the tropics at the firm's expense.

In 1948 the office of the partnership was broken into and a sum of money was stolen, the thief being caught and convicted. Part of the sum was trust monies and had to be refunded and part was money earned and owned by the firm.

In the return of income tax submitted by the partnership, the money taken by the thief and the sum of £122 7s. 5d. were shown as a properly deductible expense.

The Commissioner of Inland Revenue disallowed both deductions and his decision was upheld by the Court of Review.

On appeal from the Court of Review to the Supreme Court.

HELD.—(1) the monies set aside as a passage reserve fund were not a deductible expense.

(2) the monies stolen which were trust monies were a deductible expense.

Cases referred to:—

Dewar v. Commissioner of Inland Revenue [1935] 2 K.B. 351.
Fairrie v. Hall [1947] 2 A.E.R. 141.
Gray v. Lord Penrhyn [1937] 3 A.E.R. 468.
Mitchell v. B. W. Noble Ltd. (1927) A.C. 719.
Stocker v. Commissioners of Inland Revenue [1919] 2 K.B. 702

P. Rice for the appellant.

P. N. Dalton, Solicitor-General, for the respondent.

CAREW, P.J.—I deal first with the Passage Reserve Fund of £151 16s. 9d. It is contended that this sum has never been received by the taxpayer, Phillip Rice ; it has been received by the partnership firm, but under the Income Tax Ordinance, the individual partners, not the partnership firm are taxable.

A partnership is defined by section 2 of the Income Tax Ordinance (Cap. 152) as an "association of persons carrying on a business as partners or in receipt of income jointly, but does not include company." Section 11 (5) enacts that "any persons carrying on business in partnership shall be liable for tax in their individual capacity only." A taxpayer pays tax on his chargeable income, which is defined by section 3 (*a*) as the total income of that person subject to certain deductions. Total income (section 3 (1)) means, briefly, the annual net profit or gain directly or indirectly received, whether divided or distributed or not.

In England the partnership business is taxed, whereas in Fiji the members of a partnership firm are taxed. Despite the difference in system one can nevertheless derive some assistance from a consideration of general taxation principles which are applied in England.

Under the English and also the Australian system partnerships are required to submit partnership returns. In the former case a joint assessment is made in the partnership name while under the Australian system, except in certain cases, a partnership is not liable to be assessed as such: the return being necessary in order that the members of the partnership may be assessed on their proper shares of the partnership profits. In Fiji the practice of requiring partnerships to furnish partnership returns is followed for the purpose of ascertaining net profits.

Messrs. Rice and Stuart furnished a partnership return in which the sum of £122 7s. 5d., shown as a passage reserve fund, was claimed as a deduction. Although the partnership agreement provides that the sum reserved is to be taken from the net profits, the amount is shown in the partnership return as an expense properly deductible as having been incurred in earning the gross receipts. In arriving at the net profit the Commissioner disallowed the deduction.

It is not contended that the whole of this sum was spent in the year of assessment; part of it was spent. The claim now is for the deduction of the whole of the fund reserved. In arriving at the net profits or gain one may usefully consider the principles of English taxation practice. The English system differs from that in Fiji so it can serve only as a guide. The English Income Tax Act 1918, Rule 3, Schedule D, required that in computing the amount of profit or gain to be charged, no sum shall be deducted in respect of " any disbursement or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment or vocation," and " any loss not connected with or arising out of the trade, profession, employment or vocation." A number of English authorities were cited to show how the Courts apply these rules in practice. In dealing with this appeal I propose to be guided by the principles followed by the English Courts; and, on a consideration of the authorities to which I have been referred, I think the Commissioner was correct when he disallowed the sum of £122 7s. 5d. reserved for the payment of passages.

The position then is that the net profit becomes the joint income of the partners. The appellant admits that for the purpose both of income tax and the partnership agreement, the meaning of net profit is the same. He argues, however, that he is not taxable on the net profit but only in respect of so much of it as he has received, that is to say, his share of the profits. He argues that he has not received the money reserved in the passage fund as part of his share of the profits, and that therefore he is not liable to pay tax on it. He cites the case of *Dewar v. Commissioner of Inland Revenue* [1935] 2 K.B. p. 351, as authority for the principle that in order to become subject to tax, money must be received by a taxpayer in his taxable capacity or it must be lying to his use.

The Crown contends that as the appellant has received the net profit jointly with his partner he is liable to be taxed on it in his individual capacity; that he is taxable as an individual on the profits of the partnership; and that he has received the money in the fund, in the sense in which the word is used in *Dewar's case* (*supra*), in his taxable capacity.

English Income Tax Act, 1918, Schedule D, provides:—

> "Where a trade or profession is carried on by two or more persons jointly, the tax in respect thereof shall be computed and stated jointly and in one sum, and shall be separate and distinct from any other tax chargeable on those persons or any of them, and a joint assessment shall be made in the partnership name."

The profits are then shared by the partners according to the partnership agreement. *Proviso (ii) of section* 20 *of the Income Tax Act of* 1918 reads:—

> "The income of a partner from a partnership carrying on any trade, profession or vocation shall be deemed to be the share to which he is entitled during the year to which the claim relates, in the partnership profits, such profits being estimated according to the several rules and directions of this Act."

Although under the English system partners are taxed on their shares of the profits, it does not follow that the whole of the firm's statutory income must necessarily be divisible among the partners as their income. In the case of *Stocker v. Inland Revenue Commissioners* [1919] 2 K.B. 702, where partners in a business bequeathed to them by will were required by the trustees of the will to set aside a percentage of the net profits to form a reserve fund to cover possible future losses, the partners' income was only the balance remaining of the firm's profits after setting aside the sum reserved. This decision turned on certain provisions whereby income may be diminished by an annual payment reserved or charged thereon. In this case it appeared that if the partners had been in control of the reserve fund and if it had been for their benefit, no deduction would have been allowed. But in fact it was otherwise.

There is nothing in the Fiji Income Tax Ordinance to indicate that partners should not be taxed on their share of the partnership profits ; they have received the undivided net profit. There are, furthermore, no provisions similar to those governing the decision in *Stocker v. Commissioners of Inland Revenue* (*supra*), but even if there were, the reserve fund under consideration could not be regarded as reducing the share of the partners' profits, as this reserve is under their control and is for their use and benefit.

The appellant's share of the partnership profits is his share as an "individual"; he is taxed on this share, and this share includes the money set aside in reserve in the proportion to which he is entitled to share the profits. I do not think this view conflicts with the general principles emerging from *Dewar's case* (*supra*).

The appellant's second objection is to the refusal of the Commissioner to allow as a deduction the sum of £151 16s. 9d. which was stolen from the office of Messrs. Rice and Stuart as the result of a burglary. The English authorities to which my attention has been drawn apply the same test to loss by thefts as to any other loss; that is to say they

seek to ascertain whether loss fails within the rules in Schedule D. Although in some cases loss has been allowed, such as in the case of loss by the fraud of a servant, no authority has been cited to me to show that loss by burglary, to which there are no special considerations, has been allowed.

There is a passage from the judgment of *Macnaghton, J. in Fairrie v. Hall* [1947] Vol. 2 A.E.R., p. 141, in which he quotes *Lord Loreburn, L.C.*, as saying: "A deduction may be allowed on account of loss . . . The Act does not affirmatively state what losses may be deducted. It furnished merely negative information. A deduction cannot be allowed on account of loss not connected with or arising out of such trade. That is one indication. And no sum can be deducted unless it be money wholly and exclusively laid out or expended for the purposes of such trade. That is another indication. Beyond this the Act is silent. In my opinion, however, it does not follow that if a loss is in any sense connected with the trade, it must always be allowed as a deduction; for it may be only remotely connected with the trade, or it may be connected with something else quite as much or even more than with the trade. I think only such losses can be deducted as are connected with in the sense that they are really incidental to the trade itself. . . ."

The loss to the appellant can be divided into two parts (a) the loss of money the property of the firm, and (b) the loss of money held in trust for clients. Insofar as (a) is concerned, I do not think this can be a proper deduction, and in my opinion the Commissioner was right in disallowing it. But as regards the trust money, different considerations apply. In order that their clients should suffer no loss the firm replaced the sums stolen. In doing so the firm had its interests and good name to consider. I think that the amount refunded was a proper business outgoing. It was a loss in the sense contemplated by *Lord Loreburn*. In coming to this view, I rely on the principles as they were applied to the facts in the case of *Gray v. Lord Penrhyn* [1937] 3 A.E.R. 468, and the case of *Mitchell v. B. W. Noble Ltd.* (1927) A.C. 719.

Other than that the sum of money refunded to replace the stolen trust monies is allowed as a good deduction, the decision of the Court of Review is affirmed.