Privy Council Appeal No. 27 of 1954

Comptroller of Income Tax - - - - - - - *Appellant*

v.

Harrisons and Crosfield (Malaya) Limited - - - *Respondent*

FROM

THE SUPREME COURT OF THE FEDERATION OF MALAYA

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 8TH MARCH, 1956

Present at the Hearing:

LORD OAKSEY
LORD MORTON OF HENRYTON
LORD RADCLIFFE
LORD COHEN
MR. L. M. D. DE SILVA

[*Delivered by* LORD RADCLIFFE]

This appeal from the Supreme Court of the Federation of Malaya turns upon the meaning of a proviso attached to section 39 of the Income Tax Ordinance, 1947 (Malayan Union Ordinance No. 48 of 1947) as subsequently amended. The questions at issue are wholly questions of law, no facts being in dispute. To explain the nature of these questions it is necessary to make some reference to the system of income-tax that has been established in the Malayan Federation.

Income tax was first introduced into the Federation by the Ordinance of 1947. Both the income of individual persons and the profits of incorporated companies fall under its charge; but whereas the chargeable income of individuals except non-residents and, generally speaking, trustees and executors is subjected to a progressive tax at varying rates specified in a schedule to the Act, the income of companies bears tax at a flat rate. The income of non-residents and trustees and executors is also charged at a flat rate, though not necessarily at the same rate as that applicable to companies. For instance, for the year 1951, the year to which the present appeal directly relates, the company rate was 30 per cent. and the rate for non-residents and trustees and executors 20 per cent.

When a company resident in the Federation pays a dividend it has statutory authority to deduct from the amount of the dividend tax at the rate paid or payable by the company "on the chargeable income of the year of assessment within which the dividend is declared payable" (see section 40). Dividends themselves are included in the income of individuals that is brought under tax (section 10), they are reckoned gross without allowance for the tax deducted (section 26), and the recipient gets a set-off for the amount deducted against the tax charged on his chargeable income (section 42). These provisions have much in common with the U.K. system of taxing income from dividends.

Finally, it is relevant to notice what is meant by the phrase "chargeable income" in this connection. Its meaning is built up by successive stages in the enacting part of the Ordinance. First, in Part III, entitled "Imposition of Income Tax", section 10 provides that "Income tax shall . . . be payable at the rate or rates specified . . . for each year of assessment upon the income of any person" derived from certain

specified sources. The next part, Part IV, is entitled "Ascertainment of Income" and lays down a number of rules for the ascertainment of income, dealing with such matters as deductions or allowances for depreciation, and other matters bearing upon the nature of taxable income. Part V, headed "Ascertainment of Statutory Income", lays down the general rule that "the income of any person for each year of assessment (hereinafter referred to as "statutory income") shall be the full amount of his income for the year preceding the year of assessment from each source of income possessed by him at any time during the year of assessment, notwithstanding that any such source does not produce income during the year of assessment" (section 31 (1)). The year of assessment is itself the calendar year from January to December, and thus prima facie the income for any year of assessment would be the income, ascertained as required by the Act, which had accrued or arisen during the preceding calendar year. This would apply to incomes from trade as much as to other incomes: but with regard to incomes from trades and other profit-making enterprises, the Comptroller of Income Tax is authorised to accept the profits of the previous accounting year instead of the previous calendar year as constituting the statutory income, if he is satisfied that the business accounts are usually made up according to such an accounting period. Thus the respondent's statutory income for the year 1951 consisted of its profits for the trading year which ended on the 30th June, 1950. Next, in Part VI of the Ordinance, "Ascertainment of Assessable Income", section 33 (1) provides "The assessable income of any person from all sources chargeable with tax under this Ordinance for any year of assessment shall be the remainder of his statutory income for that year" after allowance for certain further deductions, such as business losses and charitable contributions. Finally, there emerges from this process what is called in Part VII a "chargeable income", itself defined in the following terms "The chargeable income of any person for any year of assessment shall be the remainder of his assessable income for that year after the deductions allowed in this Part of this Ordinance have been made". The deductions then specified are in effect personal allowances and life insurance relief.

It is in the context of this taxation scheme that the provisions of sections 38 and 39, which begin Part VIII, must be read. These sections (as amended up to and including the year 1951) are as follows:—

> 38. There shall be levied and paid for each year of assessment upon the chargeable income of every person, other than a company, a person not resident in the Federation, a trustee (not being the trustee of an incapacitated person), or an executor, tax at the rates set forth in the Second Schedule to this Ordinance.
>
> 39. Subject to the provisions of section 36 of this Ordinance, there shall be levied and paid for each year of assessment upon the chargeable income of—
>
> (*a*) every company, tax at the rate of thirty per centum on every dollar of the chargeable income thereof;
>
> (*b*) every person not resident in the Federation, trustee (other than the trustee of an incapacitated person), and executor, tax at the rate of twenty per centum on every dollar of the chargeable income thereof:
>
> Provided that where any company proves to the satisfaction of the Comptroller that any dividends have been paid out of such chargeable income, or any trustee proves to the satisfaction of the Comptroller that any beneficiary of the trust is entitled to a share of the trust income, an amount equal to such dividends in the case of a company or a corresponding share of the statutory income of the trustee in the case of a trust may be charged at a lower rate or not charged with any tax as the Comptroller shall determine.

The present proceedings relate to the respondent's income tax for the year of assessment 1951. What happened was that in November, 1950, the company declared a dividend of $533,333 in respect of the profits of its

trading year which had ended on the preceding 30th June. From that dividend it deducted income tax at the rate of 20 per cent., being the rate payable on company profits for the assessment year then current (as section 42 permitted) and accordingly paid a net dividend of $426,667 to its shareholders. For the year of assessment 1951 the rate of tax on company profits was raised to 30 per cent., as section 39 (*a*) now provides. Thereupon the respondent applied to the appellant for a reassessment of its tax for 1951 on the ground that under the proviso to section 39 a rate of 20 per cent. only ought to be charged on that part of its chargeable income for 1951 which was equivalent to the gross amount of dividend, namely $533,333, paid in November, 1950. The appellant refused to admit the respondent's right to this reduction of rate. The Board of Review constituted under the Income Tax Ordinance, to whom the respondent appealed, overruled this refusal and awarded to the respondent the reduction of rate which it claimed: and both the High Court and the Court of Appeal have upheld this award.

The first question which their Lordships must deal with is the appellant's reason for his refusal. There is no doubt what the reason was. From the beginning he maintained that the dividends paid in November, 1950, were not paid out of the chargeable income of the year of assessment 1951 within the meaning of those words in the proviso to section 39 and therefore that he had no legal power to apply the proviso in the respondent's favour. That is a legal point which relates to the construction of the words of the Ordinance. There seems some reason to suppose that the point was as good as abandoned before the Court of Appeal, and it is clear that it was passed over without any real argument. But the Court felt at liberty to express its own view upon it; and in the circumstances their Lordships thought it best to allow the point to be fully argued before them, if only to avoid the unsatisfactory situation that might result from dealing with the other points of law arising on the section 39 proviso upon a hypothesis as to the conditions of its operation which might itself be incorrect.

The appellant's case is that, for the proviso to apply, the dividends in question must have been paid out of income which accrues or arises during the year of assessment itself, viz. 1951. Alternatively, he says that at any rate the dividends must have been paid during that year. But this is to give to the words "chargeable income" a meaning for this purpose which is flatly in contradiction with the meaning which has been built up for them by the previous sections of the Ordinance to which reference has been made. "Chargeable income" is derived through "assessable income" from "statutory income"; and "statutory income" is the income of the preceding year, calendar year or accounting year. "Chargeable income" is therefore the income of the preceding year, less certain prescribed allowances and deductions. There is nothing in the context of the proviso which can give it a different meaning. The appellant invokes the familiar conception of the U.K. tax system that computation by a previous period as basis is merely a way of measuring the income of the year of charge and that it is that income which remains the true subject of charge. But even if their Lordships were to accept his assumption that the somewhat metaphysical theory of the U.K. system has any application to sections 10 and 31 and the other relevant sections of the Malayan Ordinance, it would remain clear that the words "chargeable income" have a precise statutory meaning under the Ordinance which precludes the application to them at any rate of any such theory.

All the Courts in Malaya before whom this point has come have taken the same view that the respondent's payment of dividend in November, 1950, did satisfy the condition required for the operation of the proviso. In their Lordships' opinion they were right. It follows that the appellant has been wrong throughout in supposing that he was not legally entitled to exercise his power under the proviso in favour of the respondent.

The next question is, what is the effect of the proviso. Again, all the Courts in Malaya have taken the same view. In their view the appellant had no discretion whether or not to exercise the power which the proviso

gave him. Not only was it his duty to make some reduction of rate in favour of the respondent, but it was, apparently, his positive duty to charge an amount of the chargeable income equivalent to the gross amount of the dividends at a rate of 20 per cent. instead of the rate of 30 per cent. ruling for the year. The Order of the Board of Review stands in that form and no appeal against it has succeeded. It is not entirely clear from the judgments in the High Court and the Court of Appeal in what terms the learned judges analysed the appellant's duty ; but the words of the Court of Appeal's judgment—" The conclusion therefore at which we arrive is that the answer to the first question is that the Comptroller, in the particular circumstances set out in the proviso, cannot leave the rate of tax unaltered and is bound either to charge at a lower rate (namely, twenty per centum) or at no rate in his discretion "—seem to assume that the respondent must reduce the rate to at least 20 per cent.

In their Lordships' opinion this construction of the proviso is misconceived. The Ordinance has said that the specified amount of income may be charged at a lower rate or may be exempted from tax as the appellant shall determine, and some compelling reason has to be found if these words, which prima facie connote that the appellant, the assessing authority, may or may not put the proviso into operation, are to be read as meaning that he must put it into operation whenever the prescribed condition as to dividends has been satisfied. If the words themselves connote that the appellant has an initial discretion whether to act at all separate from his discretion as to what reduced rate (down to nil) is to be fixed if there is to be a reduction, it is necessary to find something in section 39 itself or the general context which converts this apparent discretion into a peremptory duty.

The respondent has sought to find the necessary implication by arguing that the true and perhaps the only purpose of the proviso is to deal with the difficulty in which it is itself involved—that is, an increase in the flat rate of tax on company profits which leaves a company that has paid a dividend in the preceding year out of those profits with a recoupment of tax from its shareholders less than the tax that it subsequently has to bear upon the amount of profits distributed. And this seems to be the line of argument that has commended itself to the Courts in Malaya. It is true, of course, that in such a case a company fails to pass on to its shareholders the full burden of income tax on the profits it distributes: and the fact that the tax system has failed to provide it with the means of doing so might be thought to justify an exercise of the proviso to the extent of a remission of tax on its profits by the Revenue. It is true, at any rate, that the powers of the Comptroller were used for an analogous purpose in 1948, the opening year of the income tax régime. On the other hand it is worth remarking that the tax system of the U.K. does not attempt to harmonise the rate at which income tax is charged on profits with the rate at which a company may deduct the tax from dividends by way of recoupment ; and if the tax charge on the company's income is not regarded as being merely an indirect method of charging the shareholders' incomes that is no sufficient reason why it should.

However this may be, their Lordships are satisfied that there is nothing which allows it to be said that the proviso is exclusively concerned with the situation that results when the company rate rises from one year to another ; and nothing accordingly which obliges the appellant to make the adjustment of rate for which the respondent contends. The qualifying condition is not that dividends have been paid out of chargeable income in a year when a lower rate ruled, but simply that dividends have been paid out of chargeable income. Secondly, if the proviso really concealed a statutory scheme to bring about this sort of adjustment, it should equally have provided for increasing the rate of tax on a company which had paid dividends out of chargeable income in a preceding year of assessment when a higher current rate was in operation : for in that case the company would have gained, not lost, at the expense of the shareholders. Yet nothing is provided for except reduction of rate or complete

exemption from tax. Finally, there is no reasonable answer to the question why the Legislature expressed itself in the permissive form that it adopted, allowing expressly a discretionary rate of reduction, if its true intention was to bring about an automatic and fixed reduction of rate whenever dividends had been paid as prescribed and the company rate of tax was increased.

The appellant on the other hand propounds a very different explanation of the purpose of the power given to him by the proviso. According to his argument the object of reducing the rate of tax on the distributed part of a company's profits is to enable that part of the profits which by distribution has passed into personal income and so come within the range of progressive taxation to be charged at a rate equivalent to the effective rate of tax on that part of the shareholder's or shareholders' income. There is this much to be said in favour of this explanation that a company's power to recoup itself in dividends at its current rate bears hardly to some extent on a shareholder whose effective rate on his dividend is much below that rate and who has to wait to settle his accounts with the Revenue before he can get the benefit of the difference. Moreover the Ordinance has (by amendment) associated the power to reduce the rate of tax on company profits with the power to reduce the rate of tax on trust income, the one proviso covering both ; and in its application to trust income it does not seem possible to find any purpose in the proviso except to reduce the flat rate on trust income to the effective rate which is appropriate to that part of the beneficiary's income. Their Lordships are not prepared to say that the appellant's argument on this point is ill-founded, though they entertain considerable doubt whether, if this be the purpose or one of the purposes of the proviso, it has been created in a form which will allow it to serve as a satisfactory instrument for that purpose in the case of company profits, since the situation envisaged is that a dividend will have been paid and the company's deduction, therefore, made before the power to reduce the company's rate can ever be invoked. Moreover the effective individual rate on dividends may vary with each shareholder.

In these circumstances their Lordships take the view that it is impossible for any Court of law to choose between these profferred explanations of the purpose of the power since there is no material provided by the wording or context of the Ordinance upon which a legal choice or rejection can be made. This is a case in which the makers of the Ordinance have seen fit to create a discretion in the assessing authority to exempt part of income from taxation or to reduce the rate of tax. They have prescribed the condition upon which alone that power can arise, but, having done that, they have chosen words which indicate that the power is permissive, not mandatory, and they have made no further regulation as to the nature or object of the power. The situation thus brought about is exceptional and not necessarily satisfactory. It is possible that the Ordinance needs reconsideration on this point. But, however that may be, it is not open to a Court of law to take over the work of law making and to create for the taxpayer a legal right to have the discretionary power exercised in his favour in a particular way. Yet, without the introduction of some such illegitimate conception, how can a discretion which, on any view, covers a power to fix any rate from something below 30 per cent. to nothing be converted into a fixed duty to charge at 20 per cent?

It remains to consider what order ought to have been made by the Board of Review on the respondent's appeal to it. The appellant raised a preliminary point before the Board and subsequently maintained before the Courts that no appeal could be made against his action, apparently on the ground that the application of the proviso was a matter entirely within his discretion. Probably what he meant was not that an appeal did not lie, but that no ground would appear for interfering with his discretion. But such an objection could not possibly succeed in the circumstances of this case, in which the appellant has in fact never attempted to exercise his discretion at all, through his mistaken belief

that in law it was not open to him to do so. His objection was rightly rejected in all Courts. On the other hand the Order that has been made in the respondent's favour is based on the view that the proviso creates a legal right in the respondent to have the rate reduced, which view, as their Lordships hold, is itself ill-founded. The true position is that, while the respondent is an aggrieved person within the meaning of section 75 (1) of the Ordinance, its grievance consists, not in the fact that its rate has not been reduced, but in the fact that owing to a misconception of the law on the part of the appellant he has failed to consider whether and to what effect he ought to exercise his power to reduce it.

Their Lordships are of opinion that the right thing to do is to direct the appellant to take the respondent's application into consideration and to deal with it upon the basis of the law as now explained. This is not a case in which the Court ought to substitute a decision of its own for the discretion vested by statute in the assessing authority and so send the assessment back to the appellant with a direction as to the amendment that he ought to make. In some cases that is the appropriate action for a Court to take (see *Minister of National Revenue* v. *Wright's Canadian Ropes Ltd.*, 1947 A.C. 109). But here the appeal Courts, from the Board of Review upwards, have had to deal with a failure to consider the exercise of a power, intended by the Ordinance to be entrusted to the assessing authority, when the failure has arisen from no other reason than that the authority believed that in law the condition had not arisen which authorised the power to be put into operation. In these circumstances the best way of carrying out the purpose of the Ordinance is to follow the course taken in *Pioneer Laundry & Dry Cleaners Ltd.* v. *Minister of National Revenue* 1940 A.C. 127 by treating the appellant's refusal to entertain the respondent's application as being unfounded in law and therefore invalid and directing him now to take the matter properly into consideration.

Their Lordships will humbly advise Her Majesty that the appeal should be allowed: that the Orders of the Board of Review dated 26th August, 1952, of the High Court dated 11th February, 1953, and of the Court of Appeal dated 8th June, 1953, should be reversed, except so far as the first mentioned Order holds that the respondent's dividends paid in 1950 were paid out of the chargeable income for the year of assessment 1951 : and that in lieu thereof it should be declared (1) that the appellant's refusal to entertain the respondent's application dated 27th February, 1952, for the exercise of his power under section 39 of the Income Tax Ordinance was invalid, and (2) that the appellant ought now to proceed to take the said application into consideration on the footing that the dividends referred to were paid out of such chargeable income. Having regard to the fact that throughout the proceedings each party has in effect contended for a position which in law is not maintainable, their Lordships think that each should pay his or its own costs of the hearings and of this appeal.

(39615) Wt. 8064—69 100 3/56 D.L.

In the Privy Council

COMPTROLLER OF INCOME TAX

v.

HARRISONS AND CROSFIELD
(MALAYA) LIMITED

[DELIVERED BY LORD RADCLIFFE]

Printed by HER MAJESTY'S STATIONERY OFFICE PRESS,
DRURY LANE, W.C.2

1956