

21, 1957

No. 3 of 1956.

# In the Privy Council.

ON APPEAL  
FROM THE COURT OF APPEAL FOR EASTERN AFRICA.

UNIVERSITY OF LONDON  
25 FEB 1958  
INSTITUTE OF ADVANCED  
LEGAL STUDIES

BETWEEN  
COMMISSIONER OF INCOME TAX . . . . Appellant  
AND  
WILLIAMSON DIAMONDS LIMITED . . . . Respondent.

49838

## Case for the Appellant.

RECORD.

10 1. This is an appeal brought by leave from the Judgment and Order of the Court of Appeal for Eastern Africa dated the 7th April, 1955, allowing the Respondent's appeal against the Judgment of the High Court of Tanganyika dated the 11th May, 1954, which had dismissed the Respondent's appeal from a decision of the Local Committee confirming an assessment to income tax made by the Appellant upon the Respondent. pp. 27-35 pp. 15-16 p. 1

20 2. The question submitted for the decision of the Court of Appeal arose in reference to an assessment to income tax, No. 14782, made upon the Respondent under the provisions of the East African Income Tax (Management) Act, 1952, for the year of income 1951 upon the sum of £9,740 being an amount in respect of dividends deemed to have been distributed to the Respondent in the year 1951 as a shareholder in Buhemba Mines Limited by reason of an order made by the Appellant under Section 21 of the Tanganyika Income Tax (Consolidation) Ordinance, No. 21 of 1950.

30 3. The substantial question of law arising on this appeal is whether in applying the said Section 21 (which provides for certain undistributed profits of a company to be treated for income tax purposes as having been distributed to the members of the company) the Appellant was entitled to decide that the declaration of a dividend by the Company would not have been unreasonable and, in particular, whether the words "having regard to losses previously incurred by the company or to the smallness of the profits made" required the Appellant to decide that as Buhemba Mines Limited had sustained capital losses and had appropriated its trading profit in writing off unproductive capital expenditure it would have been unreasonable for that Company to have declared a dividend.

4. For the year 1951 income tax was chargeable in Tanganyika under both the Tanganyika Income Tax (Consolidation) Ordinance, No. 27 of 1950 (hereinafter referred to as "the 1950 Ordinance") and the East African Income Tax (Management) Act, 1952 (hereinafter referred to as "the 1952 Act"). The 1950 Ordinance imposed a charge of tax for the "year of assessment" 1951 upon income of the immediately preceding year, that is to say, the calendar year 1950. The 1952 Act imposed a charge of tax for the "year of income" 1951 upon income of the calendar year 1951. The 1952 Act contained transitional provisions whereby the continuity of the operation of the law relating to income tax was preserved; and in this present case the assessment in question, although made pursuant to the provisions of the 1952 Act for the "year of income" 1951, was in respect of an amount deemed to be income of that year by force of a notice given under Section 21 of the 1950 Ordinance. It has throughout been common ground, however, that the only provisions of the law material to the matter in dispute are contained in the 1950 Ordinance. 10

Section 21 of the 1950 Ordinance, with which this appeal is particularly concerned, reads, so far as is presently material, as follows:—

"21. (1) Where the Commissioner is satisfied that in respect of any period for which the accounts of a company resident in the Territory have been made up, the profits distributed as dividends by that company up to the end of the sixth month after the last date upon which its accounts for that period are required by virtue of the provisions of the Companies Ordinance to be laid before the company in general meeting, increased by any tax payable thereon are less than sixty per cent. of the total income of the company ascertained in accordance with the provisions on this Ordinance for that period, he may, unless he is satisfied that having regard to losses previously incurred by the company or to the smallness of the profits made, the payment of a dividend or a larger dividend than that declared would be unreasonable, by notice in writing order that the undistributed portion of such sixty per cent. of total income of the company for that period shall be deemed to have been distributed as dividends amongst the shareholders as at the said last date and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purposes of this Ordinance : 20 30

Provided that—

(a) when the reserves representing accumulations of past profits which have not been the subject of an order under this subsection exceed the paid up capital of the company, together with any loan capital which is the property of the shareholders, or the actual cost of the fixed assets of the company whichever of these is greater, this subsection shall apply as if instead of the words 'sixty per cent.' the words 'one hundred per cent.' were substituted . . . " 40

(A company's accounts for any accounting period are required by Section 123 (1) of the Tanganyika Companies Ordinance (Cap. 212 Laws of Tanganyika 1947) to be laid before the company in general meeting not more than nine months after the end of that accounting period.) 50

In Section 2 of the 1950 Ordinance, the word "loss" in relation to a trade, business, profession or vocation is defined as meaning, unless the context otherwise requires, loss computed in like manner as profits; "total income" as meaning the aggregate amount of the income of any person from the sources specified in Part III of the Ordinance remaining after allowing the exemptions under Part IV and computed in accordance with the provisions of Part V; and "year of assessment" as meaning the period of twelve months commencing on 1st January, 1940, and each subsequent period of twelve months.

10 The 1952 Act received the Royal Assent on the 11th of June, 1952.

Section 1 of the 1952 Act provides that, subject to the provisions of the Fifth Schedule, the Act shall be deemed to have come into operation on the 1st January, 1951. In Section 2, the definition of "loss" and "total income" are identical with those used in Section 2 of the 1950 Ordinance; the expression "year of income" is defined as meaning the period of twelve months commencing on 1st January, 1951, and each subsequent period of twelve months; the expression "East Africa" as meaning all or any of the following territories, Kenya, Tanganyika, Uganda and Zanzibar; and the expression "Territorial Income Tax Ordinance" 20 as meaning, in its application to each territory, the Ordinances of that Territory relating to the rates of tax and allowances.

Section 8 imposes a charge to income tax upon the income for the year of income commencing on the 1st January, 1951, and for each subsequent year of income of, *inter alia*, any person resident in East Africa in respect of specified sources of income; and Section 22 is in terms substantially similar to those of Section 21 of the 1950 Ordinance.

Section 98 provides for the transitional provisions of the Fifth Schedule to the Act to have effect for the purposes of the transition from the provisions of the enactments repealed by the Act to the provisions of 30 the Act. Subject to the provisions of the Fifth Schedule, Section 99 repeals, *inter alia*, the 1950 Ordinance.

Paragraph 1 of the Fifth Schedule provides for the repealed enactments to continue to apply to income tax chargeable thereunder up to and including the year of assessment commencing on the 1st January, 1951. Paragraph 2 of the Schedule makes effective any act done under the repealed enactments which could have been lawfully done under the 1952 Act. Paragraph 3 of the Schedule provides that the continuity of the law relating to income tax shall not be affected by the substitution of the 1952 Act for the repealed enactments.

40 5. The facts of the case appear from the Statement of Facts by the Respondent, the Judgments of the High Court and the Court of Appeal for Eastern Africa and the Balance Sheet of Buhemba Mines Limited, items 3, 5, 10 and 14 in the Record of Proceedings and are summarised below :—

pp. 3-6  
pp. 15-16  
pp. 27-33  
pp. 39-44

(i) Buhemba Mines Limited (hereinafter referred to as "the Company") is a limited liability company. The issued capital, all fully paid up, of the Company at all material times was £192,350

divided into 156 Founders' Shares of £500 each, £78,000 ; 1,440 Ordinary Shares of £50 each, £72,000 ; and 847 Cumulative Preference Shares of £50 each, £42,350.

(ii) The Respondent was the holder of 156 Founders' Shares and 1,139 Ordinary Shares in the Company.

(iii) In Miscellaneous Civil Cause No. 51 of 1951, certain of the Company's Preference Shareholders petitioned for the Company to be wound up owing to the directors' failure to redeem the Cumulative Preference Shares. This petition was dismissed in the High Court of Tanganyika and an appeal from the decision of that Court was 10 dismissed by the Court of Appeal for Eastern Africa. The dividend on the Cumulative Preference Shares was in arrears as from 1st January, 1947.

(iv) The Company's income for income tax purposes for 1950, after allowing deduction for an outstanding balance of income tax losses in respect of the years 1945, 1946 and 1947, amounted to £38,160.

(v) In its accounts for the year 1950 the Company appropriated Shs.587,469 (£29,373. 9s.) in writing off 20 per cent. of the cost of development of a mine which it had abandoned as worthless in or 20 about 1948. There remained on the Balance Sheet an item of Shs.1,174,935 (£58,746. 15s.) representing the cost of such development which had still to be written off.

(vi) The Company declared no dividend in respect of the year 1950.

(vii) The Appellant served notice under Section 21 of the 1950 Ordinance deeming 60 per cent. of the Company's income for 1950 to have been distributed among the shareholders. Sixty per cent. of £38,160 amounts to £22,896 (Shs.457,920) of which the Respondent's share amounted to £9,740 (Shs.194,800.32). 30

(viii) The Respondent was assessed under the 1952 Act, in Notice of Assessment No. 14782 for the year of income 1951, in the sum of £9,740 (tax being charged thereon at Shs.9,740).

(ix) The Respondent appealed against this assessment to the Local Committee, which confirmed the assessment. (The decision of the Local Committee at page 1 of the Record expresses to find the assessment correct "under Section 22 of the East African Income Tax (Management) Act, 1952." The notice was in fact served under Section 21 of the 1950 Ordinance since on the date on which it was given, that is, the 25th April, 1952, the only 40 legislation in force was the 1950 Ordinance. The income of the Company was thus deemed to form part of the income of the shareholders for the calendar year 1951 and so came into assessment for the year of income 1951 under the provisions of the 1952 Act.)

6. The Respondent appealed to the High Court of Tanganyika against the decision of the Local Committee. The appeal came on for hearing in the High Court (Mahon, J.) on the 4th May, 1954, and on the 11th May, 1954, the Court delivered judgment dismissing the appeal with costs.

Mahon, J., said that the argument of the Respondent (the then Appellant) was based on four grounds, namely :—

p. 15, ll. 18-30

(i) that Section 21 of the Ordinance should never be applied to a case where the accounts showed an over-all capital deficiency ;

(ii) that the word " losses " in Section 21 should be widely interpreted to include capital losses ;

10 (iii) that having regard to such capital losses and to the decisions of that Court and of the Court of Appeal for Eastern Africa in Miscellaneous Civil Cause No. 51 of 1951 (already referred to), the Appellant (the then Respondent) should have held that it would have been unreasonable for the Company to have distributed a dividend ; and

(iv) that it would have been wrong to distribute profits to any persons other than the Preference Shareholders because such a distribution would contravene the Companies Ordinance and the Company's Articles of Association.

Mahon, J., referred to the Company's accounts for 1950 and to the judgments in Miscellaneous Civil Cause No. 51 of 1951 and said that he could find no ground for holding that the Company's balance sheet for 20 1950 showed an over-all deficiency of capital. That being so, he held that it was unnecessary for the purpose of deciding the appeal to construe the meaning of " losses " in Section 21.

p. 15, l. 31-  
p. 16, l. 18

p. 16, ll. 19-20

Mahon, J., said that the question as to whether or not it would be wrong to distribute profits to any person other than the Preference Shareholders would depend upon whether such distribution was made before or after the date upon which the Preference Shares became redeemable. Since it was not possible to decide upon that date, the question could not be determined.

p. 16, ll. 21-26

7. The Respondent appealed to the Court of Appeal for Eastern Africa 30 against the judgment of the High Court of Tanganyika. The appeal came on for hearing (Nihill, P., Worley, V.-P., and Briggs, J.A.) on the 14th March, 1955, and on the 7th April, 1955, the Court delivered judgment allowing the appeal with costs there and in the High Court and ordering that the matter be remitted to the Appellant with a direction that the existing order under Section 21 was unlawfully made and must be treated as a nullity, that the assessment based on such order be annulled, that the Appellant reconsider the whole matter and that, in so doing, he should consider the position of the Company from a commercial point of view, regarding the accounts as a prudent man of business would, and should 40 not make any such order if, having regard to such considerations, he was of opinion that a dividend could not fairly be paid.

pp. 27-33

pp. 34-35

Briggs, J.A., who delivered the leading judgment, after referring to the history of the litigation, mentioned the Respondent's (the then Appellant's) contention that the payment of any dividend to the holders of Founders' or Ordinary Shares before redemption of the outstanding Preference Shares would have been an invasion of the rights of the

p. 28, ll. 17-21

p. 28, ll. 22-26

Preference Shareholders. He observed that this point had not been substantiated since no argument had been addressed to the High Court or to the Court of Appeal upon it and that the Articles of Association of the Company had not been included in the record before the Court.

p. 28, ll. 27-30

p. 29, l. 23-  
p. 30, l. 3

Briggs, J.A., went on to consider the Respondent's argument that, although the Company had made a profit in 1950, it had previously incurred capital losses and that there was still an over-all capital deficiency. After referring to the accounts, he said that the facts established were that the Company had two mines of which one was worthless; a large sum spent on the worthless mine had been lost and was being written off 10 but the other mine was working and producing profits. Since the value of the second mine was not shown, in the balance sheet or otherwise, it was not possible to determine the Company's true capital position and no over-all capital deficiency could be demonstrated.

p. 30, ll. 4-16

p. 30, ll. 17-24

Briggs, J.A., however, disagreed with the view expressed by Mahon, J., that it was unnecessary, if there was no over-all capital deficiency, to construe the meaning of "losses" in Section 21. He thought that Mahon, J., had either misunderstood or had failed to deal with the Respondent's contention that, even so, the Commissioner ought to have been satisfied that "having regard to losses previously incurred by the 20 Company or to the smallness of the profits made the payment of a dividend . . . would be unreasonable." Briggs, J.A., accepted that the general purpose of Section 21 was to deal with the special mischief of a company which persistently refrained from distributing its profits so that such profits ultimately accrued to the shareholders in tax-free form on winding up.

p. 31, l. 4-  
p. 32, l. 23

He said that a number of objections could be taken to the Appellant's (the then Respondent's) argument that the words "losses" and "profits" in Section 21 must refer to losses and profits ascertained in accordance with income tax law. He observed that, in the first place, the decision of 30 the Bombay High Court in *Sir Kasturchand Ltd. v. C.I.T., Bombay* [1949] 17 I.T.R. 493, upon Section 23A of the Indian Income Tax Act, 1922—a provision in *pari materia* with the relevant part of Section 21—was an authority against the Appellant in that the Court there held that the Income Tax Officer must consider "the smallness of the profit made by the company in contradistinction to the assessable income of the company . . ." Secondly, he remarked that, if the Appellant's construction were right, the only difference between "profits" and "total income" would depend upon exemptions under Part IV of the Ordinance. Thirdly, 40 although he accepted that the provisions of Part III of the Second Schedule to the Ordinance—Deductions in respect of Mining Operations—were to be borne in mind, he did not consider that the provisions of Part III could themselves provide an answer to the general question of construction. He expressed himself as deriving little help from English law. Section 245 of the United Kingdom Income Tax Act, 1952, was very different from Section 21 of the Ordinance, but Section 246 showed that in England, where the ultimate mischief was the same as in Tanganyika, it was thought right that the Commissioners should examine the general requirements of the company's business and might consider the whole capital position of

the company. This demonstrated that where a section dealt with these particular problems, there was no reason to be surprised if it departed from ordinary income tax principles.

In the result, Briggs, J.A., accepted the Respondent's argument that the power to make an order under Section 21 was entirely discretionary and that, before such an order could properly be made, it must appear not only that the company concerned had distributed less than 60 per cent. of its taxable income for the relevant period but also that in the commercial sense there were available profits out of which a dividend ought to be declared. He said that the Commissioner was not absolutely bound by the accounts put forward by the directors but that his approach should be to consider the accounts put before him as a prudent business man would; he should not make an order under Section 21 if on the whole he was of opinion that, on that footing, the board could not fairly be expected to pay a dividend.

Briggs, J.A., thought it clear that the High Court had not considered the matter on the correct footing and that the Appellant and the Local Committee had approached the question on the view of the law which the Appellant had put forward and which was in his opinion an incorrect view. It was therefore necessary that the matter should be re-examined with a view to a decision based on different principles. Although the Appellant had exercised his discretion under Section 21 on wrong principles he remained the proper person to exercise that discretion. The matter should be remitted to him with a direction that the existing order was unlawfully made and must be treated as a nullity. It remained open to him to reconsider the whole matter and to take such steps as might be proper.

Sir Barclay Nihill, P., and Sir Newnham Worley, V.-P., concurred.

8. By an Order dated the 14th November, 1955, the Court of Appeal for Eastern Africa granted conditional leave to the Appellant to appeal to Her Majesty in Council from the Judgment and Order of that Court and by further Order dated the 3rd February, 1956, granted final leave to appeal.

9. The Appellant respectfully submits that the Court of Appeal departed from the meaning of the words used in Section 21 of the 1950 Ordinance in favour of a broad construction founded on the presumed intention of that section.

The section does not require the Appellant to be satisfied that the company concerned has not made reasonable distributions by way of dividend; the Appellant has a discretion to apply the section unless he is satisfied that the payment of a dividend would be unreasonable. There is, in the Appellant's submission, nothing unreasonable in the payment by a company of a dividend out of a fund of profit available for distribution, without taking account of any capital losses which that company may have sustained. Nor is the soundness of this proposition affected by the consideration that the fact of previous losses, whether of capital or of income, may provide a good reason for not paying a dividend at all. There

is no dichotomy between reasonable and unreasonable dividend payments ; the restraint upon the exercise of the Appellant's discretion is imposed only by reference to dividends the payment of which would have been unreasonable. The Appellant also suggests that there is nothing in the context of the section to justify a departure from the meaning attributed to the word " loss " in the definition section of the Ordinance and that losses must be computed in like manner as profits. The word " profits " is not defined in the Ordinance, but its meaning generally therein must be that of income profit ; in particular, it would be inconsistent with any possible view of the purpose of Section 21 to attach to the phrase " the smallness of the profits made " the meaning of " capital profits " and the word " losses " should, therefore, be construed in the same sense. The Appellant also submits that the Court of Appeal, in accepting that the general purpose of Section 21 was to deal with the special mischief that shareholders might receive income profits in non-taxable form, was stating the case too narrowly, and that the broad object was to deprive shareholders in companies—other than those in which the public are substantially interested—of any considerable taxation advantage over individuals and partnerships ; had this Company been carried on by the members in partnership, they would have had to pay tax on its income notwithstanding the writing-off in respect of unfruitful capital development. It is further submitted that the decision of the Bombay High Court in *Sir Kasturchand Ltd. v. C.I.T., Bombay* [1949] 17 I.T.R. 493, does not afford any support to the contention that the word " losses " in Section 21 includes capital losses ; the distinction which the Bombay High Court was drawing in that case was one between accounting profits and assessable income but there is no suggestion in the decision that the former profits included capital losses or gains.

10. The Appellant humbly submits that the decision of the Court of Appeal for Eastern Africa is wrong and should be reversed and that this appeal should be allowed with costs both here and below for the following among other

## REASONS

- (1) BECAUSE the question to which the mind of the Commissioner was required by Section 21 of the Ordinance to be addressed was not whether there were available profits out of which a dividend ought to have been declared by Buhemba Mines Limited but whether, having regard to losses previously incurred by that Company, the payment of a dividend out of its profits for the year 1950 would have been unreasonable.
- (2) BECAUSE notwithstanding the losses previously sustained by Buhemba Mines Limited on capital account its conduct, if it had resolved to pay a dividend out of its profits for the year 1950, would not have been unreasonable.
- (3) BECAUSE (in the alternative) the words " losses previously incurred " in Section 21 denote losses sustained



on income account and do not comprise losses of fixed capital, and on this footing no losses had been previously incurred by Buhemba Mines Limited.

- (4) BECAUSE the decision of Mahon, J., was well-founded.
- (5) BECAUSE the judgment delivered by Briggs, J.A., in the Court of Appeal (in which the other members of the Court concurred) was right in so far as it held that there was no evidence that Buhemba Mines Limited had sustained an over-all capital loss but wrong in so far as it held that the discretion vested in the Commissioner by Section 21 had been exercised on wrong principles.

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F. HEYWORTH TALBOT.

RODERICK WATSON.

**In the Privy Council.**

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**ON APPEAL**  
*from the Court of Appeal for Eastern Africa.*

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**BETWEEN**  
**COMMISSIONER OF INCOME**  
**TAX . . . . .** *Appellant*  
**AND**  
**WILLIAMSON DIAMONDS**  
**LIMITED . . . . .** *Respondent*

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**Case for the Appellant.**

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