

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*

49837

AND

WILLIAMSON DIAMONDS LIMITED *Respondent.*

Case for the Respondent

RECORD.

10 1. This is an Appeal from a Judgment and Order of the Court of Appeal for Eastern Africa (Nihill, P., Worley, V.-P., and Briggs, J.A.), dated the 7th April 1955, allowing the Appeal of the Respondent from a Judgment of the High Court of Tanganyika (Mahon, J.), on the 11th May 1954, whereby an Appeal by the Respondent from an assessment purported to have been made upon it by the Appellant, as confirmed by the Local Committee for the Trust Territory of Tanganyika on the 23rd January 1954, was dismissed.

pp. 27-33, 34.
pp. 15-16.
p. 1.

20 2. By section 22 of the East African Income Tax (Management) Act 1952 (hereinafter called "the East African Act") which repealed and replaced section 21 of the Tanganyika Income Tax (Consolidation) Ordinance 1950 (hereinafter called "the Tanganyika Ordinance") it is provided that where the Commissioner of Income Tax (the Appellant in this case) is satisfied that in respect of any period for which the accounts of a company resident in Tanganyika have been made up the amounts distributed as dividends by that company up to the end of the twelve months after the date to which such accounts have been made up, 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 of the Act 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 of a larger dividend than that declared would be unreasonable, by notice in writing order that the undistributed portion of sixty per cent. of such total income of the company for that period shall be deemed to have been distributed as dividends amongst the shareholders.

3. The main issue in this case is whether in exercising his powers under section 22 of the East African Act the Appellant when considering whether the payment of a dividend or a larger dividend than that declared would be unreasonable ought to take into account the general financial position of a company to which the section applies from a commercial point of view or ought to take into consideration only "revenue losses" as ascertained in accordance with the other provisions of the East African Act. 10

4. Section 22 of the East African Act, and section 21 of the Tanganyika Ordinance, together with section 23 (a) of the Indian Income Tax Act 1922 (as amended) (to which reference was made in the judgment hereinafter referred to as being in *pari materia* with section 22 of the East African Act) all have their origin in section 21 of the Finance Act 1922 of the United Kingdom (now, as amended, and as relevant to this appeal, sections 245, 246 and 255 Income Tax Act 1952 of the United Kingdom). The principal object of this legislation was and is to prevent the avoidance of assessment to surtax of profits of companies controlled by a small number of persons by the withholding of distributions to the members of such profits in such manner as to render the amount not distributed liable to be included in the statements of the total income of such members respectively. 20

p. 31, l. 8.

5. The part of Section 22 of the East African Act which affects the issue in this case is as follows :—

" 22. (1) Where the Commissioner is satisfied that, in respect of any period for which the accounts of a company resident in the Territories have been made up, the amounts distributed as dividends by that company up to the end of twelve months after the date to which such accounts have been made up, 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 of this Act 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 sixty per cent. of such total income of the company for that period shall be deemed to have been distributed as dividends amongst the shareholders as at the end of the sixth month after the date to which such accounts have been made up and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purposes of this Act." 30 40

6. The part of Section 21 of the Tanganyika Ordinance which subject to the provisions of the Fifth Schedule of the East African Act was repealed by Section 99 thereof which affects the issue in this case is as follows :—

10 “ 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 of 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 sixty per cent. of such total income of the company for that period shall be deemed to have 20 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.”

7. The part of Section 23A of the Indian Income Tax Act 1922 (as amended) which appears to be in *pari materia* with Section 22 of the East African Act is as follows :—

30 “ 23—A. (1) Where the Income-tax Officer is satisfied that in respect of any previous year the profits and gains distributed as dividends by any company up to the end of the sixth month after its accounts for that previous year are laid before the company in general meeting are less than sixty per cent. of the assessable income of the company of that previous year as reduced by the amount of income-tax and supertax payable by the company in respect thereof, he shall, unless he is satisfied that having regard to losses incurred by the company in earlier years or to the smallness of the profit made, the payment of a dividend or a larger dividend than that declared would be unreasonable, make with the previous approval of the Inspecting Assistant Commissioner an order in writing that the undistributed portion of the assessable income of 40 the company of that previous year as computed for income-tax purposes and reduced by the amount of income-tax and super-tax payable by the company in respect thereof shall be deemed to have been distributed as dividends amongst the shareholders as at the date of the general meeting aforesaid, and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purpose of assessing his total income.”

8. The relevant parts of Section 21 of the Finance Act 1922 of the United Kingdom (as amended) from which Section 22 of the East African Act derives its origin has been re-enacted in the Income Tax Act 1952 of the United Kingdom of which the following sections are material :—

“ 245.—With a view to preventing the avoidance of the payment of surtax through the withholding from distribution of income of a company which would otherwise be distributed, it is hereby enacted that where it appears to the Special Commissioners that any company to which this section applies has not, within a reasonable time after the end of any year or other period for which accounts have been made up, distributed to its members, in such manner as to render the amount distributed liable to be included in the statements to be made by the members of the company of their total income for the purposes of surtax, a reasonable part of its actual income from all sources for the said year or other period, the Commissioners may, by notice in writing to the company, direct that for purposes of assessment to surtax, the said income of the company shall, for the year or other period specified in the notice, be deemed to be the income of the members, and the amount thereof shall be apportioned among the members.”

“ 246.—(1) In determining under the last preceding section whether any company has or has not made such a distribution of its actual income as is therein mentioned, the Special Commissioners shall have regard not only to the current requirements of the company's business but also to such other requirements as may be necessary or advisable for the maintenance and development of that business.”

9. The facts in the present case may be summarised as follows :—

The Respondent is the holder of 156 Founders' and 1,139 Ordinary Shares in Buhemba Mines Ltd. (hereinafter called “ the Company ”) and the total income for income tax purposes of the Company for the trading year 1st January to 31st December 1950 was £38,160 (income tax losses for the years 1945–7 as reduced by income tax profits for the years 1948–9 having been taken into account). This said figure was agreed by the Respondent and income tax at the appropriate company rate has been duly paid thereon.

No dividends were distributed by the Company to the Respondent (nor to any other person) in respect of the said trading year 1950.

In the Balance Sheet and Accounts of the Company for the year ended the 31st December 1950 there appears an item of Shs. 1,174,935./30 shown as the balance of “ old Development to be written off ” and it is admitted (as is the case) by the Appellant that this item did not represent any reserves of workable ore, being the cost of development of a mine which proved to be worthless.

p. 3.

p. 4.

p. 4, l. 19.

p. 28, l. 46.

The Respondent contended and now contends that in the circumstances the said Balance Sheet and Accounts disclose an overall capital deficiency which must be taken into account in considering :—

(A) the general commercial and financial position of the Company, and, consequently,

(B) the question whether or not a distribution of dividends to shareholders could, in all the circumstances, reasonably be made.

10. In the month of August 1951 a petition was presented to the
 10 High Court of Tanganyika entitled “In the matter of the Companies Ordinance (cap. 212) and In the matter of Buhemba Mines Ltd. Miscellaneous Civil Cause No. 51 of 1951 ” by five holders of redeemable preference shares in the Company for the compulsory winding up of the Company principally upon the ground that the redeemable preference shares in the Company ought to have been redeemed on the 1st January 1950 and, since they had not been so redeemed, it was just and equitable that the Company should be wound up. p. 9.

11. The petition was heard on the 20th February 1952 by Sinclair J. who held (*inter alia*) that such redeemable preference shares could only be
 20 properly redeemed out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purpose of such redemption, and that since, in effect, there were no such profits, the Company was not obliged to redeem the said preference shares. The petition was accordingly dismissed and on appeal to the Court of Appeal for Eastern Africa, on the 16th January 1953, the judgment of Sinclair, J. was affirmed. 20 E.A.C.A., p. 28.

12. By an order, dated the 25th April 1952, the Appellant purporting to act under section 22 of the East African Act ordered that 60 per cent.
 30 of £38,160 (the total income for income tax purposes of the Company for the trading year ending the 31st December 1950 as set in paragraph 9 hereof) that is to say £22,896 (or Shs. 457,920), should be deemed to have been distributed as dividends to the shareholders of the Company and the proportionate amount thereof so deemed to have been distributed to the Respondent amounted to £9,740 (or Shs. 194,800/32). On the 3rd December 1953 the Appellant purported to make the Assessment No. 14782 for the year of income 1951 upon the Respondent in respect of the said amount of £9,740 (tax thereon being charged at £487 or Shs. 9,740). pp. 4, 1, 6. p. 2.

13. The said assessment having been confirmed by the Local
 40 Committee on the 23rd January 1954 the Respondent appealed to the High Court of Tanganyika and Judgment was delivered therein on the 11th May, 1954 upholding the decision of the Local Committee. pp. 7, 13, 15. p. 15.

14. The contentions advanced on behalf of the Respondent before the High Court were, shortly stated, as follows :—

pp. 10, 15.

(1) that the provisions of Section 22 of the East African Act (or section 21 of the Tanganyika Ordinance) could have no application in a case where the accounts of the company show an overall capital deficiency and that the relevant accounts of the Company disclosed such a deficiency :

(2) that the word “ losses ” in the said section should be widely construed to include capital losses :

(3) that having regard to the capital losses suffered by the Company and to the judgments of the High Court and of the Court of Appeal for Eastern Africa referred to in paragraph 11 hereof the payment of a dividend for the trading year 1950 would have been unreasonable and the Appellant should have so decided : and 10

(4) even if the contentions set out at (1) (2) and (3) were wrong any distribution of profits to persons other than preference shareholders would have constituted a contravention of the Companies Ordinance.

15. The contentions advanced on behalf of the Appellant before the High Court were as follows :— 20

(1) that it was impossible to say that the accounts of the Company showed an overall capital deficiency :

(2) that as “ profits ” for the purpose of the East African Act meant “ revenue profits ” as opposed to “ capital profits ” similarly “ losses ” could only mean “ revenue losses.”

(3) that the judgments of the High Court and the Court of Appeal for Eastern Africa referred to in paragraph 10 hereof merely decided that the action of the directors of the Company in not paying dividends was not so unreasonable as to justify a compulsory winding-up of the Company. 30

16. In his judgment in the High Court Mahon, J. held :—

p. 16.

(i) that the Accounts and Balance Sheet of the Company for the trading year 1950 did not disclose an overall deficiency of capital, and, therefore

(ii) that in the circumstances, it became unnecessary to construe the meaning of “ losses ” for the purpose of Section 21 (1) of the Tanganyika Ordinance 1950 (or section 22 (1) of the East African Act) : and

(iii) that the Appeal of the Respondent must accordingly fail.

p. 17.

17. On the 30th August 1954 the Respondent served upon the Appellant a memorandum of Appeal to the Court of Appeal for Eastern Africa upon the grounds therein set out. 40

18. The Appeal came before the Court of Appeal for Eastern Africa and was argued on the 14th March 1955. On the 7th April 1955 the judgment of the Court was delivered by Briggs, J.A. (Nihill, P. and Worley V.-P., concurring) and it was *inter alia* ordered :— pp. 18-27.

(1) that the appeal be allowed ;

(2) that the matter be remitted to the Appellant with a direction that the existing order was unlawfully made and must be treated as a nullity ; pp. 24, 35.

10 (3) that the assessment based on the said existing order be annulled ;

(4) that the Appellant reconsider the whole matter and do take such steps as may be proper ;

(5) that the Appellant in determining whether an order should be made under Section 21 of the Tanganyika Ordinance should consider the position of the Company from a commercial point of view regarding the accounts as a prudent business man would and should not make any such order if having regard to such consideration he is of opinion that a dividend could not fairly be paid.

20 19. In delivering judgment in the Court of Appeal, Briggs, J.A., held that the Annual Accounts and the admission of the Appellant that the item of Shs. 1,174,935/30 did not represent any reserves of workable ore, being the only evidence before the Court, did not establish and would not be of any service in establishing an overall capital deficiency such as should or might influence the conduct of the Appellant. pp. 28, 29, 30.

30 20. However, Briggs, J.A., then held that “ losses ” in section 21 of the Tanganyika Ordinance did not have the limited meaning for which the Appellant contended and could include, in effect, “ capital losses.” In coming to this conclusion, he derived assistance from the decision of the High Court of Bombay in *Sir Kasturchand Ltd. v. C.I.T. Bombay* (1949), 17 I.T.R. 493, in which the High Court of Bombay, in considering the provisions of section 23 (a) of the Indian Income Tax Act 1922 (as amended) held (at page 497) that the Income Tax Officer must consider “ the smallness of the profit made by the company . . . not the assessable income of the company but the actual income of the company.” p. 31, l. 6.

40 21. Briggs, J.A., then stated : “ I derive little help from English law. Section 245 of the 1952 Act is very different from section 21 of the Ordinance, but the provisions of section 246 have at least this importance, that in England, where the ultimate mischief is the same as in Tanganyika, it is thought right that the Commissioners should examine the ‘ current requirements of the Company’s business ’ and also requirements ‘ for the maintenance and development of that business,’ and may, with certain specified exceptions, consider the whole capital position of the Company. See also *Montague Burton Ltd. v. C.I.R.*, 20 T.C. 48, at 68-9. This is no direct authority for the construction of section 21, but I think it has just

this importance, that where a section deals with these particular problems there is no reason to be surprised if it departs from ordinary income tax rules and methods and requires the Commissioner to consider the position of the Company from a commercial point of view. On the best consideration I can give to the question, I think that is the true effect of section 21. I do not mean, of course, that the Commissioner is absolutely bound by the accounts put forward by the directors. He might in any case say: 'This provision is not a matter of prudent or cautious commercial accounting, but a mere concealment of profits which should be distributed.' That, however, should be the exceptional case, and unless it arises I think the Commissioner's approach to the matter should be to consider the accounts put before him as a prudent business man would, and if on the whole he is of opinion that on that footing the board could not fairly be expected to pay a dividend, he should not make an order under section 21. 10

p. 32, l. 35.

If I am right, I think it is clear that the High Court at least has not considered the matter on the correct footing, and, although we have no means of knowing the reasoning on which the Commissioner or the Local Committee based their respective decisions, I do not think it would be disputed that their approach to the question was based on the view of the law which the Respondent has put forward to us, and which is in my opinion an incorrect view. It is therefore necessary that the matter should be re-examined with a view to a decision based on different principles." 20

p. 32, l. 48.

22. Briggs, J.A., finally stated that section 21 of the Tanganyika Ordinance vested a special discretion in the Appellant, which, in this case, he had exercised on wrong principles. The order was wrongly made and the assessment based on it ought to be quashed. Nevertheless the Appellant remained the proper person to exercise such discretion, and the matter should be remitted to him for reconsideration. 30

23. As regards the application of section 21 of the Tanganyika Ordinance to the matter in issue, it is respectfully submitted that both Mahon, J., and the Court of Appeal for Eastern Africa do not appear to have directed their attention to the transitional provisions of the East African Act by virtue of which dividends deemed to have been distributed on or after 1st January 1951 would represent income chargeable to tax under the provisions of the East African Act (sections 1 (1), 8 (1), 96 (1), 99 (b) and paragraph 1 of the Fifth Schedule to the said Act).

p. 6.
pp. 1, 2.

24. In the circumstances of this case the dividends could not have been deemed to have been distributed at any date prior to the 31st December 1950 (nor is it alleged that they were to be so deemed) but they were deemed to have been distributed on the 30th September 1951, and, accordingly were sought to be charged in, and as income of, the year of income 1951. 40

25. It is submitted that the validity or otherwise of the Order and Assessment purported to have been made by the Appellant should be determined by reference to the East African Act and in particular Section 22 thereof, and not by reference to Section 21 of the Tanganyika Ordinance.

26. It is further submitted that the operative words relevant to this Appeal of Section 21 of the Tanganyika Ordinance have been retained in Section 22 (1) of the East African Act and, therefore, that the observations of the Court of Appeal for Eastern Africa as to the true construction and effect of Section 21 of the Tanganyika Ordinance apply equally to Section 22 of the East African Act *mutatis mutandis*. p. 32.

27. As stated in paragraph 4 hereof, Section 22 (1) of the East African Act, Section 21 (1) of the Tanganyika Ordinance and Section 23 (A) of the Indian Income Tax Act 1922, as amended, all have their origin in Section 21 of the Finance Act 1922 of the United Kingdom (as amended). The true meaning effect and limit of operation of all these enactments should, it is submitted, be gathered from the proviso to subsection (1) of the parent Section 21 of the Finance Act 1922 of the United Kingdom (now Section 246 (1) of the Income Tax Act 1952 of the United Kingdom), by which it is required that "regard must be had not only to the current requirements of the company's business but also to such other requirements as may be necessary or advisable for the maintenance and development of the business." p. 31.

28. It is contended that in applying Section 22 (1) of the East African Act regard must be had to :

(I) actual profits as ascertained in accordance with established principles of commercial accounting ; and

(II) to the question whether in all the circumstances of the case under consideration it would be reasonable for a prudent business man to distribute all or any part of such profits as a matter of sound commercial policy taking into account *inter alia*, "losses previously incurred." Even if in a given case there may be in any one year substantial profits it may nevertheless be unreasonable to make any distribution of dividends when the capital position and maintenance and development requirements of the Company as a whole are considered (*Montague Burton Ltd. v. C.I.R.* (1936), 20 T.C. 48, 68 ; *Thomas Fattorini (Lancashire) Ltd. v. C.I.R.* (1942), 24 T.C. 328) in which event no order under Section 22 (1) of the East African Act would fall to be made.

29. Leave to appeal to Her Majesty in Council was granted by the Court of Appeal for Eastern Africa on the 3rd February 1956.

30. The Respondent therefore humbly submits that the Appeal be dismissed and the Judgment of the Court of Appeal for Eastern Africa be upheld and affirmed for the following among other

REASONS

- (1) BECAUSE in the circumstances the Appellant should have been satisfied that the payment of a dividend would have been unreasonable.
- (2) BECAUSE in the absence of any provisions in Section 22 (1) of the East African Income Tax (Management) Act 1952 as to how " losses previously incurred " 10 and " profits made " are to be ascertained for the purposes of the said Section 22 (1), the scope of the phrases are to be determined by the application of ordinary commercial principles and practice.
- (3) BECAUSE the Appellant in determining whether an Order should be made under Section 22 of the East African Act should consider the position of the Company from a commercial point of view, regarding the accounts as would a prudent business man (giving due weight, inter alia, to losses previously incurred) and, having 20 taken such considerations into account, should not have made such order.
- (4) BECAUSE having regard to the said considerations, the financial position of the Company was such that a dividend could not properly and reasonably be distributed.
- (5) BECAUSE the Appellant failed to discharge the onus which was upon him to show that the Respondent had acted unreasonably in not declaring a dividend in respect of the period in question. 30
- (6) BECAUSE the Appellant when making the order applied the wrong principles and misdirected himself in law.
- (7) BECAUSE the said order and assessment were unlawfully made and must be treated as a nullity and discharged.
- (8) BECAUSE the judgment of the Court of Appeal for Eastern Africa on the points of principle and construction arising in this case was right and should be upheld.

ROY BORNEMAN.

S. L. NEWCOMBE.

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Case for the Respondent

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