

HERBERT GREENING *v.* MORRIS, HEDSTROM, LTD.

[Civil Jurisdiction (Corrie, C.J.) October 22, 1943.]

*Income Tax Ordinance, 1921*¹—s. 11—*position of holders of preference shares subscribed for before enactment of income tax legislation in the Colony—whether the Company is bound or entitled to deduct income tax from dividends—whether the deduction if made, should be at the rate paid by the Company or that paid by individuals.*

Plaintiff was the holder of preference shares in the defendant Company. He sought in this action a determination of the rate at which income tax was to be deducted from dividends by the Company.

HELD.—(1) The Company is bound to deduct income tax from dividends payable to preference shareholders.

(2) The deduction should be at the rate payable by the Company for the year of assessment without regard to the amount of tax paid or payable by the Company to revenue in respect of that year, or to the profits out of which the dividends are paid.

[**EDITORIAL NOTE.**—There have been substantial amendments to the Income Tax Ordinance since this decision. By virtue of the amending Ordinance of 1945 the provisions as to surtax are now contained in a new section 11A. As to the points on which the decision is based.

(a) The exemption of shareholders other than absentees from liability to pay normal tax on their dividends (previously contained in s. 3—(1) (c)) is continued and appears in s. 11—(3) of the amended ordinance (Income Tax (Amendment) Ordinance, 1945 s. 4). Paragraph (c) of s. 3—(1) of the Ordinance of 1921 was as follows :—

“ Dividends received by or credited to shareholders of a
“ corporation which is liable to taxation under the provisions
“ of this Ordinance shall not be liable to the normal tax in
“ the hands of the shareholders, but shall be liable to the
“ surtax provisions of this Ordinance or any amendment
“ thereto, provided that the said surtax payable on such
“ dividends shall be the difference between the appropriate
“ rate of surtax and the normal tax. The amount of the
“ exemption from the normal tax to the shareholder shall
“ not exceed the net amount of such dividends after the
“ deduction of the interest or carrying charges (if any) in
“ respect of such dividends. Nothing in this Ordinance
“ shall be so construed as to prevent a company from de-
“ ducting the income tax from dividends payable to share-
“ holders or to a particular class of shareholders and in the
“ case of preference shareholders the company shall deduct
“ the income tax from dividends payable unless the condi-
“ tions governing the issue of such preference shares shall
“ provide to the contrary.”

¹ Cap. 152.

- (b) The exemption for companies, other than non Fijian Companies, in favour of profits earned outside the Colony which appeared in s. 11—(3) of the Ordinance of 1921 is no longer in force (S. 3A—(c) of the amended Ordinance—as amended by s. 3 of the Income Tax (Amendment) Ordinance, 1945).
- (c) The rate of tax levied and paid upon the chargeable income of Companies is now set out in s. 11—(1) of the amended Ordinance.

It will be noted that the final words of this paragraph (which make it binding upon the Company to deduct income tax from preference shareholders dividends) are omitted from the amended Ordinance. See now *Johnson v. Morris Hedstrom Limited & or* [1946] Fiji L.R.—.]

Cases referred to :—

(1) *Bradbury v. English Sewing Cotton Co.* [1923] A.C. 744.

(2) *Neumann v. The Inland Revenue Commissioners* [1934] A.C. 215.

ORIGINATING SUMMONS for determination of two questions on the construction of the Income Tax Ordinance, 1931. The facts and argument appear from the judgment.

A. D. Leys for the plaintiff.

R. A. Crompton for the defendant.

CORRIE, C.J.—By this summons the plaintiff, Herbert Greening, a holder of ordinary shares in Morris, Hedstrom, Limited, seeks the determination of the following questions: (1) whether, upon the true construction of the Income Tax Ordinance 1921, the defendant Company, Morris, Hedstrom, Limited, is bound or entitled to deduct from the dividends payable to the Company's preference shareholders any income tax; (2) whether, upon the true construction of the Income Tax Ordinance 1921, the Company is bound or entitled to deduct from the dividends payable to the preference shareholders tax at the rate paid by the Company or at the rate paid by individuals.

A summons raising the same questions was issued against the Company by John Thomas Johnson, a holder of preference shares. By agreement between the parties he has been joined as a defendant to this summons.

No issue of fact is raised by the summons. The material facts are that Morris, Hedstrom, Limited was registered on the 12th October, 1910, as a company, under ss. 159 and 160 of the Partnership Consolidation and Limited Liability Ordinance, 1878. Under powers contained in its Memorandum and Articles of Association, the Company has issued both preference and ordinary shares. Preference shares were subscribed for before the enactment of income tax legislation in this Colony, and each preference share is issued *pari passu* with all other preference shares. The conditions under which the preference shares are issued, endorsed upon the share certificates, are as follows :—

“ These preference shares shall confer the right to a fixed
 “ cumulative preferential dividend at the rate of £6 per centum
 “ per annum on the capital for the time being paid up thereon and
 “ the right in a winding up to a payment off of capital (and arrears
 “ of dividend whether declared or undeclared up to the commence-
 “ ment of the winding up) in priority to all other shares, but shall
 “ not confer any further right to participate in profits or assets ”.

A substantial part of the profits of the Company is earned from territories outside the limits of the Colony.

Neither of the parties to this summons is an absentee, as defined in s. 2 of the Income Tax Ordinance 1921.

S. 11 (1) of that Ordinance, as originally enacted, provided as follows :—

“11.—(1) There shall be assessed levied and paid upon the
“ income during the preceding year of every person other than an
“ absentee—

“ (i) who resides or ordinarily resides in the Colony ; or

“ (ii) who resides in the Colony during any calendar year for a
“ period or periods equal to one hundred and eighty-three
“ days: or

“ (iii) who is employed in the Colony ; or

“ (iv) who not being a resident of the Colony derives income
“ for services rendered in the Colony to any person
“ resident or carrying on business in the Colony but only
“ on that portion of the income so earned by such non-
“ resident—

“ (a) one shilling per pound upon all income exceed-
“ ing two hundred and fifty pounds in the case
“ of unmarried persons and widows or widowers
“ without dependent children and persons who
“ are not supporting dependent brothers or sisters
“ under the age of eighteen years or a dependent
“ parent or parents grandparent or grandparents
“ and exceeding five hundred pounds in the case
“ of all other persons and not exceeding five
“ thousand pounds ;”

Paragraphs (b) to (f) inclusive, provided for higher rates of taxation upon incomes exceeding £5,000 per annum. By s. 2 of the Ordinance, the tax payable under paragraph (a) was included in the definition of normal tax ; while the tax payable under paragraphs (b) to (f) was included in the definition of surtax.

Sub-s. (3) of s. 11 provided that,

“ Corporations and joint stock Companies no matter how created
“ or organized shall pay in and for every year five per centum on
“ all income earned in or derived in or from the Colony. Any
“ corporation or joint stock company the fiscal year of which is not
“ the calendar year shall make a return and have the tax payable
“ by it computed upon its income for its fiscal year ending within
“ the calendar year for which the return is being made.”

S. 3 (1) defines “ income ” for the purpose of the Ordinance and specifies certain exemptions and deductions to be allowed in calculating income. Among these exemption and deductions there was included by Ordinance 22 of 1921 the following :—

“ (c) dividends received by or credited to shareholders of a cor-
“ poration which is liable to taxation under the provisions of
“ this Ordinance shall not be liable to the normal tax in
“ the hands of the shareholders but shall be liable to the
“ surtax provisions of this Ordinance or any amendment

“ thereto provided that the said surtax payable on such
 “ dividends shall be the difference between the appropriate
 “ rate of surtax and the normal tax. The amount of the
 “ exemption from the normal tax to the shareholder shall
 “ not exceed the net amount of such dividends after the
 “ deduction of the interest or carrying charges (if any) in
 “ respect of such dividends. Nothing in this Ordinance
 “ shall be so construed as to prevent a company from de-
 “ ducting the income tax from dividends payable to share-
 “ holders or to a particular class of shareholders and in the
 “ case of preference shareholders the Company shall deduct
 “ the income tax from dividends payable unless the condi-
 “ tions governing the issue of such preference shares shall
 “ provide to the contrary ; ”

By Ordinance 1 of 1940 the rate of normal tax under s. 11 (1) (a) was raised to 1s. 3d. per pound, and the tax on corporations was raised to 7½ per cent, that is to say, 1s. 6d. per pound. Under Ordinance 19 of 1942 the rate of corporation tax is now 25 per cent.

By Ordinance 6 of 1941 an additional tax known as “ war tax ” was imposed upon taxable incomes. From this tax corporations and joint stock Companies taxed under s. 11 (3) of the principal Ordinance were exempt. By the same amending Ordinance the definition of “ tax ” in s. 2 of the principal Ordinance was amended to include war tax as well as normal tax, surtax and the tax payable by absentees.

The provisions of the Income Tax Ordinance differ in many respects from those of the English Income Tax Acts, but it is clear that in one respect the principle of those Acts has been adopted. A corporation paying tax under s. 11 (3) is not the agent of its shareholders but is itself the taxpayer. Nevertheless, by virtue of paragraph (c) of s. 3 (1), payment by the Company of tax upon its profits under s. 11 (3) does exempt shareholders, other than absentees, from the liability to pay normal tax (or war tax) in respect of their dividends.

The position under the Ordinance, as regards normal tax, of a shareholder who is not an absentee is similar to that of a shareholder under the English Income Tax Act, 1842, with regard to which Lord Phillimore said in *Bradbury v. English Sewing Cotton Co.*, [1923] A.C. 744, 769—

“ A joint stock Company is under the Income Tax Act, 1942,
 “ treated as a person and is directed to make a return of its profits or
 “ gains according to Schedule D upon a conventional figure, arrived
 “ at by taking an average of the three preceding years, and is
 “ liable to be assessed and taxed thereupon.

“ If the principle of its being a distinct person, distinct from its
 “ shareholders, had been carried to a logical conclusion, there
 “ would have been no reason why each shareholder should not,
 “ in his turn, have to return as part of his profits or gain under
 “ Schedule D, the money received by him in dividends.

“ There taxation would seem to be logical, but it would be
 “ destructive of joint stock Company enterprise, so the Act of
 “ 1842 has, apparently, proceeded on the idea that for revenue
 “ purposes a joint stock Company should be treated as a large
 “ partnership, so that the payment of income tax by a Company

“ would discharge the quasi-partners. The reason for their discharge may be the avoidance of double taxation, or to speak accurately, the avoidance of increased taxation. But the law is not founded upon the introduction of some equitable principle as modifying the statute ; it is founded upon the provisions of the statute itself ; and the statute carries the analogy of a partnership further, for it contemplates a Company declaring a dividend on the gross gains, and then on the face of the dividend warrant making a proportionate deduction in respect of the duty, so that the shareholder whose total income is so small that he is exempt from income tax or pays at a lower rate, can get the income tax which has been deducted on the dividend warrant returned to him.”

To that extent the provisions of paragraph 3 (1) (c) are clear ; and when we come to the last sentence of that paragraph, it is equally clear that the Company is bound to deduct “ the income tax ” from dividends payable to preference shareholders, unless the conditions governing the issue of such preference shares shall provide to the contrary. No such provision to the contrary is contained in the conditions under which preference shares in Morris, Hedstrom, Limited were issued. It follows that the answer to the first question raised by this summons is that the Company is bound to deduct “ the income tax ” from dividends payable to its preference shareholders.

To the question as to the date at which such tax is to be deducted, the answer must depend upon the meaning of “ the income tax ” in the last sentence of paragraph (c). The term “ income tax ” is not defined in the Ordinance. It is used in both the title and the short title to the Ordinance, and also in ss. 3 (2), 11 (2), 11 (4), 11 (6), 11 (7) paragraphs (a), (b) and (d) ; and also in the marginal notes to ss. 11 and 12. From these sections it appears that “ income tax ” includes any tax levied upon income under the Income Tax Ordinance other than war tax.

But the real question at issue between the parties is this ; who is the taxpayer in respect of the income tax to be deducted under paragraph (c) ? Is it as the plaintiff argues, the tax upon the Company's profits that is to be deducted, or is it, as the defendant maintains the tax for which the shareholder is the taxpayer ? No authority has been cited on this question and no guidance is to be obtained from the provisions of the English Income Tax Acts. The first sentence of paragraph (c), however indicates the answer to this question. It runs ; “ dividends received by or credited to shareholders of a corporation which is liable to taxation under the provisions of this Ordinance shall not be liable to the normal tax or war tax in the hands of the shareholders but shall be liable to the surtax provisions. This is the case of any shareholder who is not liable to payment of surtax (which means a shareholder whose income does not exceed £5,000 per annum) no tax is payable in respect of dividends received by him from a corporation liable to taxation. It follows that, in the case of any such shareholder—that is to say, in the case of the great majority of the shareholders in any Company—the only income tax payable in respect of their income from the Company is the tax upon the Company's profits. I hold, therefore, that the words “ the income tax ” in the paragraph refer to the tax paid or payable by the Company under s. 11, sub-s. (3).

There remains, however, a further question to be determined. As has been stated, a part of the profits of Morris, Hedstrom, Limited are earned outside the Colony, and to that extent are exempt from taxation under s. 11, sub-s. (3). Again, it does not follow that a Company will distribute in dividends in any year the whole of the profits earned in that year or even so much of the profits as is liable to tax. And again, a Company may declare a dividend in excess of the amount of profits earned during the year, and may pay the excess out of the accumulated profits of earlier years' trading.

The question arises, therefore, whether, in deducting tax, a Company is to deduct from the dividends paid to any shareholder an appropriate part of the actual tax paid or payable by the Company in respect of the profits distributed by way of dividend, or whether the deduction is to be made upon some other basis.

A similar question has arisen under the English Income Tax Acts and was dealt with by Lord Tomlin in *Neumann v. The Inland Revenue Commissioners* [1934] A.C. page 215, at page 224. Lord Tomlin, after citing the passage from the speech of Lord Phillimore in *Bradbury v. English Sewing Cotton Company*, which has been quoted above, observed :—

“ In practice the matter did not work out quite so simply. It
“ has to be remembered that the amount distributable in dividend
“ in any year might, in view of the assessment of profits or gains
“ under Schedule D being upon the basis of the average of the
“ three preceding years as it then was, be much more or much less
“ than the amount of the assesment for that year, so that, if this
“ proportionate deduction was treated as meaning the rateable
“ proportion of the tax paid by the Company in respect of the year
“ of distribution, it might much exceed or be much less than the
“ amount which would be deducted from the dividend if the current
“ rate of tax in respect of the gross dividend had been deducted.
“ At any rate a practice seems to have grown up of Companies
“ deducting from dividends tax appropriate to the amount of the
“ dividend at the current rate of tax quite irrespective of the
“ amount of tax paid by the Company to the revenue, and of the
“ shareholders claiming exemption or abatement being treated by
“ the revenue as having paid tax to the extent of that deduction.
“ As the Company making the deduction lay under no obligation
“ to pay to the revenue anything more than the tax based upon
“ its own assessment, the result was that the tax returned to those
“ claiming exemption or abatement could rarely, if ever, have had
“ any exact relation to the amount of tax received by the revenue
“ from the recipient of returned tax.”

In the absence of any direction in the Income Tax Ordinances or in any regulations made thereunder as to the rate at which the income tax is to be deducted from dividends paid to preference shareholders, I hold that the practice referred to by Lord Tomlin, and now established for many years in England, is to be followed. The Company therefore should deduct the income tax from dividends paid to preference shareholders at the rate of tax payable by the Company under s. 11 (3) for the year of assessment, without regard to the amount of tax paid or payable by the Company to revenue in respect of that year, or in respect of the profits out of which the dividends are paid.