THE COMMISSIONER OF INLAND REVENUE

A **v.**

PACIFIC MERCANTILE LIMITED

[COURT OF APPEAL, 1990 (Tuivaga P, Tikaram JA, Palmer J) 20 March]

Civil Jurisdiction

B *Income Tax- whether a transaction was one of a series- whether in the nature of trade or business- set-off of losses- whether losses must first be set off against non-taxable profits- Income Tax Act (Cap 201) Sections 11 (1) (a), 22 (1) (a) & 22 (1) (b).*

C Certain receivables became vested in the Respondent. Their increase in value was held by the Appellant to be assessable for tax. On appeal the Court of Appeal upheld the Supreme (now High) Court's judgment that the transaction, on the facts, was neither one of a series nor in the nature of trade or business and, interpreting Section 22 (1) (a) of the Act HELD: losses in respect of transactions which, had they been profitable would be liable to tax are not first to be set off against tax exempt income.

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Cases cited:

Federal Commissioner of Taxation v. Whitfords Beach Pty Ltd 150 CLR 355
McClelland v. Federal Commissioner of Taxation 120 CLR 487
Petrotim Securities v. Ayre [1964] 1 All ER 269; [1964] 1 WLR 190
E *Sharkey v. Werner* [1956] AC 58

M.A. Khan for the Appellant
K. Handley QC & J.G. Singh for the Respondent

Judgment of the Court:

F This appeal arises from assessment to Income Tax of the Respondent in respect of the Respondent's return of income for the year ended 31st January 1979. The assessment was issued in January 1983. The assessment was followed by an objection on the part of the Respondent taxpayer and that objection was in due course dismissed by the Appellant. That was in turn followed by an appeal, by the Respondent to the Court of Review, which dismissed the appeal in respect of
G one matter but allowed it in respect of another. Both parties then appealed to the Supreme Court (now known as High Court) which dismissed the present Appellant's appeal and allowed the present Respondent's appeal. The present Appellant is now appealing to this Court against both parts of the Supreme Court Judgment seeking an Order in lieu thereof in favour of the Appellant upon all issues adjudicated upon in the Supreme Court and the Court of Review, on

three grounds. The first two grounds of appeal refer to what has been described in the proceedings as a book debt acquired by the Respondent.

They are as follows

> "(i) That the Learned Supreme Court Judge erred in law in holding that the profit or gain derived by the Respondent from sale of a certain debt, described as a "Trois Receivable", was not chargeable to tax under section 11(a) of the Income Tax Act as a profit or, gain from sale or disposition or personal property acquired for the purpose or selling or otherwise disposing of the ownership of it;
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> (ii) That the Learned Supreme Court Judge erred in law in applying to the facts of the case before him and to the resolution of the issue of taxability of profits or gains from sale of the above-described debt the exceptional principle in Sharkey v. Werner 1956 AC 58, as expanded in [1956] AC 58, as expanded in Petrotim Securities v. Ayres [1964] 1 All ER 269, [1964] I WLR 190, such principle being wholly inapposite to the facts of the instant case in view of realisable market value of the relevant debt being unascertainable;"

The factual history of that matter which is not in dispute may be conveniently summarised as follows:

The Respondent was at all material times a subsidiary of Stinson Pearce Holdings. In 1978 there was a transaction between Soqulu Plantation Limited which we shall called "Soqulu" and a Hong Kong Company called Trois Investment, Limited, which we shall called "Trois" The transaction was that Soqulu who were in some financial difficulties arranged to sell certain lands at Taveuni to Trois, the purchase price to be paid over a period of six years. Soqulu having need of the money immediately however, Trois borrowed money from Barclays Bank International for the purpose of paying Soqulu forthwith. The result of various transactions involved to bring about this result was that Stinson Pearce Holdings Limited borrowed money from the National Bank of Fiji which they utilised by passing it over to the Respondent who in turn paid out Barclays Bank. Thereupon the Trois receivables became vested in the Respondent. As the result of the various transactions Trois receivables in the hands of the Respondent had experienced an increase in value of $F602231. That increase in value was designated by the Appellant as a profit and accordingly tax was assessed thereon.

As already mentioned, following an unsuccessful objection to the Commissioner, the Respondent took that part of the assessment to the Court of Review which held that the amount of the value increase was not assessable for tax. The present Appellant appealed to the Supreme Court against the allowance of the Respondent's appeal to the Court of Review.

The proviso to Section 11 (a) of the Income Tax Act (Cap. 20)1 is relevant to this appeal and reads as follows:

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> "Provided that, without in any way affecting the generality of this section, total income, for the purpose of this Act, shall include -
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> (a) any profit or gain accrued or derived from sale or other disposition of any real or personal property or any interest therein, if the business of the taxpayer comprises dealing in such property, or if the property was acquired for the purpose of selling or otherwise disposing of the ownership of it, and any profit or gain derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit; but nevertheless, the profit or gain derived from a transaction or purchase and sale which does not form part of a series of transactions and which is not in itself in the nature of trade or business shall be excluded.

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In the Supreme Court the present Appellant contended that the Court of Review had erred in holding that the profit was not assessable as a profit or gain from sale of property acquired for the purpose of selling or otherwise disposing of it. Kermode J, in the Supreme Court held that the Court of Review had not erred in so holding and dismissed the present Appellant's appeal on that ground.

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There is no contest as to the findings of fact in the present case, nor can there be in view of the provisions of the Fiji Court of Appeal Act Section 12 (1) (c). It is common ground that the Trois receivables constitute a book debt and that the transactions of purchase and sale of the same did not form part of a series of transactions but was an isolated transaction. Kermode J, also found that the transaction was not in the nature of trade or business.

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As pointed out by Kermode J. the proviso in Section 11(a) contains three limbs which are

(1) that it was a business profit or gain from a dealing in property

(2) that it was a profit or gain from sale of property acquired for the purpose of selling or otherwise disposing of it.

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(3) that it was a profit or gain derived from the carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit.

In his appeal to the Supreme Court the present Appellant confined himself to the submission that the amount in question was assessable under No. 2 above. It is

common ground that it was intended to sell the debt to Stinson Pearce after its acquisition from Barclays's bank. However that is not the end of the matter; it is necessary to look at the proviso contained in the last part of Section 11 (a). Kermode J. found that it was common ground that the transaction did not form part of the series of transaction, so the alleged profit is nevertheless to be excluded unless the transaction is in itself in the nature of trade or business, see the last words of Section 11 (a).

We have been referred to McClelland v Federal Commissioner of Taxation 120 CLR 487 in which the Privy Council considered an appeal from the High Court of Australia. It there considered Section 26(a) of the Australian Income Tax Acts and it has been submitted that that Section is similar to the Fiji Section 11(a). In point of fact it is not on all fours with Section 11(a) because it does not contain the proviso at the end of Section 11 (a). However on pages 494, 495 ibid the Privy Council expresses the view that an undertaking or scheme as mentioned in the section, to produce the result of rendering a single transaction as producing assessable income, must exhibit features which give it the character of a business deal, although the word 'business' does not appear in the Australian Section 26(a). As already noticed that notion is in Fiji incorporated in the Section itself. It is clear that in the present case if profit making was a purpose in the acquisition and sale of the Trois receivables at all it was not the dominant purpose, see Federal Commissioner of Taxation v Whitfords Beach Party Limited 150 CLR 355 at 381.

Kermode J. referred to Petrotim Securities Ltd v. Ayres [1964] 1WLR 190. In the second ground of appeal the Appellant submits that Kermode J erred in law in applying Petrotim Securities to the facts of the present case on the grounds that the realisable market value of the relevant debt is unascertainable. Lord Denning MR on page 193 ibid said

> "It seems to me that when there is a sale at a gross under value by one associated company to another the Commissioners are entitled to find that it is not a transaction made in the course of trade. Whoever would suppose that any trader in his right senses would enter into transactions of this kind? That he would sell at a gross under value were it not that he had in mind some benefit out of making a loss?.... Such a transaction is so outside the ordinary course of business of any trader that the Commissioners were entitled to find that it was not done in the course of trade."

And further on page 194 his Lordship said

> "I would suggest, however that if it was not in the nature of trade for one of these associated companies to sell at an undervalue, it is not in the nature of trade for the other to buy at an overvalue. In each case the sale ought to be brought in at the realisable market value at the time".

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> And earlier on page 194 his Lordship had referred to the case of Sharkey v Werner [1956] AC 58 where it had been said
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> "the figures are to be regarded as struck out for tax purposes: and in their place you must put in the market realisable value at the time."

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The Appellant in the present case submits that the realisable market value is unascertainable and therefore Sharkey v Werner should not have been applied.

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As to this, Kermode J, after holding that the debt was sold at overvalue, found that the nature of the debt did not permit of any accretion in value. We are not satisfied that Kermode J was wrong in coming to that conclusion. The book debts arose in the circumstances already described and constituting a loan of a fixed amount would not be affected by any future fluctuations in value of the real property for the acquisition of which the loan was raised in the first place. In our view the book debt would never increase beyond the value paid for it.

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In our view the reality of the situation is that this was purely a paper transaction for the internal purposes of the Stinson Pearce Group. A key to it may be found in the reference to the fact that the money borrowed by the Stinson Group from the National Bank of Fiji for the purpose of paying out Barclays Bank was "passed on", as the record frequently states, to the Respondent who used it to pay off the debt. Stinson Pearce Holdings having raised the loan with NBF could quite easily have purchased the Trois receivables themselves without the intermediary of the respondent and thereby avoided the notional profit. It seems clear that the Respondent was merely a cog in the wheel of these arrangements. It may be argued that notwithstanding the Respondent being part of large commercial group, having filed its own tax return it was rightly assessed upon the same. As to that the primary Judge, Ungoed Thomas J in the Petrotim case said

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> "This company trading normally for profit, as it did, never sold such assets at such prices except at such dictation. It is only the intrusion of another body into its affairs that produces such an odd operation. As I have already said, what I am concerned with in this case is whether this company, as a separate entity, is conducting its own trade in respect of which it is assessed for its own income tax liability. In this transaction the company was not acting in the course of it's own trade, which is the subject of taxation, but out of that course. These transactions, when seen in their context of the company's trading operations, cry aloud for an explanation."

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That statement, was made after his Lordship had referred to what been said in Sharkey v Werner that a sale in that case was a dictated sale at a prescribed price.

In our view therefore the present transaction falls within the exception contained in the proviso at the end of Section 11 (a) namely that it did not form part of a series of transactions and was not in itself in the nature of trade or business. That being so the appeal on the first two grounds fails.
We now turn to the third ground of appeal which is as follows

> "That the Learned Supreme Court Judge erred in law in holding that the Respondent was entitled under Section 22 (1) (a) of the Income Tax Act to set off losses incurred by it in the relevant year against its chargeable income of subsequent years."

This part of the case concerned the interpretation of Section 22 (1) (a) of the Income Tax Act. The Act, as will be seen, uses in various parts the words "income", "total income", and "chargeable income" and provides some definitions of those terms. Section 22 (1) (a) of the Act is as follows

> "22. (1) Any loss incurred in the year in any trade, business, profession or vocation carried on by any person, either solely or in partnership, shall –
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> (a) be set off against his income from other sources for the same year;
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> Provided that no relief shall be allowed under the provisions of this paragraph in respect of any loss suffered from any transaction of trade, business, profession or vocation if a profit derived from such transaction would not have been included in chargeable income."

We note the Interpretation Act (Cap.7) interprets the word "person" to "include any company or association or body or persons corporate of unincorporate". Therefore the Section clearly applies to a company such as the Respondent. This may be contrasted with use of the term "individual" in such section as for example 21 (2). The issue here is whether the word "income" where first appearing in Section 22 (1) means total income or chargeable income as defined in the Act. The appellant contends that the word means total income and the Court of Review so held. The Respondent contends that in respect of a company it means chargeable income, and that view was upheld by the Supreme Court in the Judgment under appeal.

The Act by Section 6 imposes a "basic tax" upon (a) every $ of total income derived by a resident individual and (b) on every dollar of chargeable income of a company. By Section 7 the Act imposes a "normal tax" inter alia (in 7(e)) on resident companies in respect of their chargeable income.

Part V or the Act is headed: "Ascertainment or Chargeable Income." Section 32 (a) which is contained in that part provides as follows:

> "For the purposes of this Act the chargeable income of a company shall be (a) in respect of a company other than a non-resident company, the total income of the company for that year whether accruing in or derived from Fiji or elsewhere."

Part IV of the Act at the relevant time was in two parts:

> A: "Amounts to be included in arriving at total income," and
> B: "Amounts to be excluded in arriving at total income. Section 11(f) which was in part A included dividends paid or credited in the year.

Section 17 (37) on the other hand, which was in part B, provided that any dividend from a company incorporated in Fiji received by or accrued to a resident company shall not be chargeable to basic tax and normal tax.

However, the conflict between those two provisions is only an apparent one. Section 11 (f) makes all dividends part of total income. However, Section 21 (2) makes provision for the treatment of dividends derived by an individual. As against that Section 17 (37) deals with dividends received by a company and exempts such dividends, thereby providing an exception to Section 11 (f). In our view that construction is carried by the opening words of Section 17: The following classes of income shall not be chargeable to basic tax and normal tax".

As has been seen Section 32 provides that for a non-resident company the chargeable income is the same as the total income. This is a different situation from a resident individual because by virtue of Section 24 the chargeable income of such an individual shall be his total income subject to certain deductions allowed by Section 25, 26, 27, 29, and 30. No such deductions are available to a resident company, hence the fact that a company's total income is the same as its chargeable income.

In our view it would be a misinterpretation of the Act to hold that losses in respect of transactions which, had they been profitable, would be liable to tax should first be set off against tax exempt income. The matter may be tested by reference to Section 22 1(b). Section 22 l(a) has already been noted as providing that losses may be set off against income for the same year. Section 22 l(b) goes on to provide that

> "To the extent it is not allowed under paragraph (a) such losses may be carried forward and subject as is hereinafter provided be set off against what would otherwise have been his total income for the next six years in succession".

If the Commissioner's contentions were correct a different result would occur as between the first year and the subsequent six years. If the taxpayer company has made a business profit from its exempt dividends but has available carry forward

losses and if those are to be first set off against the tax exempt dividend income the result would be exactly the same as if those dividends were not exempt. The taxpayer would be paying tax on it because it had received those tax exempt dividends. But for the receipt of those dividends the whole of the carried forward losses could have been offset against the current year profits. However, those dividends, as the Supreme Court has held, do not form part of the respondent's; chargeable or total income and accordingly ought not to be set off against its carried forward losses under Section 22 (1)(b).

In our view the Learned Trial Judge was right when he said

> "The intention of the Section was in my view to grant relief from losses by setting off such loss against chargeable income in subsequent years. That intention is nullified by an interpretation which requires such losses to be first set off against non taxable profits. No relief is granted in such a case if profits are more than the losses."

For those reasons the third ground of appeal also fails.

Accordingly the Appeal is dismissed with costs to the Respondent.

(Appeal dismissed.)