IN THE SUPREME COURT OF FIJI

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Appellate Jurisdiction

Civil Appeal No. 15 of 1983

Between:

COMMISSIONER OF INLAND REVENUE Appellant

and

PACIFIC MERCANTILE LIMITED Respondent

Mr.M.J. Scott for the Appellant
Mr.K.C.Handley, Q.C. and Mrs. Wong for the Respondent

JUDGMENT

The Respondent appealed to the Court of Review in Review No. 2 of 1983 against the decision of the Commissioner of Inland Review (herein referred to as CIR) dated 26th day of April, 1983, disallowing objections by the respondent to the assessment in respect of the respondent's return of income for the year ended 31st June, 1979.

It is convenient to refer to the facts stated in the Court of Review's judgment:

> "The appellant is a company registered in Fiji and is a member of the Stinson Pearce Group of Companies. It started life in 1972 as Stinson Investments Limited but on 17th February, 1975 changed its name to Stinson Pearce Limited and in that capacity appears to have been the principal trading company of the group. As from 1st January, 1979 it changed its name again to Pacific Mercantile Company Limited. There are two contentions in this appeal, the first arising while the

appellant was still Stinson Pearce Limited and the second after it became Pacific Mercantile Company Limited. The first contention relates to the appellant's losses in 1975, 1976 and 1977 and turns principally upon the construction to be ascribed to section 22 of the Income Tax Act, Cap. 201. The appellant's income consists partly of income from trade and partly of income from dividends from companies registered in Fiji. The latter are exempt from basic and normal tax under section 17(37) of the Act but there is nothing there to say they are to be omitted in calculating total income."

The second contention is referred to in the Court of Review's judgment as follows:-

"I pass then to consider the appellant's second contention which relates to what was called a book debt acquired by the appellant for approximately $F2.7 million and passed on to Stinson Pearce Holdings Limited for $F3.3 million. The appellant regarded this as a capital gain. The Commissioner considered that it came within the purview of the proviso (a) to section 11 of the Act and assessed tax upon it. The appellant objected, the grounds of objection being -

(1) that the profit was of a non-taxable nature;

(2) that the profit was the result of an inter-company book entry and was therefore not derived for taxation purposes until realised in 1982, and should therefore be taxed on the cash emergence basis.

The appellant refers to the book debt as the 'Trois receivables' and I shall adopt that term. I shall preface my discussion of the matter by observing that the appellant is and was at all material times a wholly owned subsidiary of Stinson Pearce Holdings Limited. The debt arose out of transactions between Soqulu Plantation Limited which I shall call 'Soqulu' and a Hong Kong Company called Trois Investment Limited which I shall call 'Trois.' The former apparently faced what the Court was told were 'liquidity problems' in early 1978 and in order to resolve these problems made an arrangement with Trois to sell 335 lots from its Taveuni subdivision to Trois for $HK26,266,488 discounted to give it $HK19,213,333. Unfortunately, that was to be paid over six years, but since Soqulu

wanted money immediately, Trois borrowed money from Barclays Bank International, who received as security therefor a guarantee from Stinson Pearce Holdings Limited then known as Jardine Matheson & Co. (Fiji) Limited and a 'letter of comfort', which the Court was told was a sort of informal guarantee, from the parent company, Jardine Matheson & Co. Limited of Hong Kong. The upshot of all this was that Soqulu received $H14,634,745. That was March 1978.

Later in 1978 the Court was told that negotiations took place for the purchase by Fiji interests of the Jardine Matheson shares in Jardine Matheson & Co. (Fiji) Limited and those shares were transferred to a Stinson family company called Somerset Holdings Limited. As a result Jardine Matheson & Co. (Fiji) Limited changed its name to Stinson Pearce Holdings Limited, Stinson Pearce Limited became Pacific Mercantile Limited and the appellant and Stinson Pearce Holdings agreed to discharge the letter of comfort given by Jardine Matheson & Co. Limited to Barclays Bank International. Soqulu would not have been able to borrow to repay the Bank so Stinson Pearce Holdings Limited borrowed $F2.7 million from the National Bank of Fiji and passed that money over to the appellant who paid $2,267,769 to Barclays Bank. The Trois receivables then became vested in the appellant, the guarantee given by Jardine Matheson & Co. (Fiji) Limited was discharged, and the letter of comfort returned to Jardine Matheson & Co. Limited. Incidentally the premature repayment of Barclays Bank loan seems to have cost the Stinson group a further $F80,761.06 as a penalty. When the loan was raised from the National Bank of Fiji it was expected that the appellant would acquire the Trois receivables and transfer them to Stinson Pearce Holdings at a premium of $400,000. In the event the documents reveal that although a minute of Stinson Pearce Holdings Limited approved the transfer of the Trois receivables from the appellant at $F3.5 million, the price was actually $F3.3 million, thus leaving an increase in value of $F602,231 which the Revenue designated as a profit."

The Court of Review dismissed the appeal in respect of the first contention but allowed it in respect of the second.

From the latter decision the CIR has appealed to this Court. The grounds of appeal being as follows:-

"(1) (i) The Respondent, by its own admission and as found by the Court of Review, having acquired for an ascertained sum a specific identified asset, namely a debt, "personal property"; and

(ii) The Respondent having agreed and planned, by its own admission and as found by the Court of Review, prior to acquisition of said asset, that said asset be sold or disposed of for a stipulated ascertained profit or gain, and;

(iii) Said asset being sold or disposed of for the said stipulated ascertained profit or gain as admitted and held,

The Court of Review erred in law in holding that the said profit or gain was not chargeable to tax under section 11(a) of the Income Tax Act as a profit or gain from sale or disposition of personal property acquired for the purpose of selling or otherwise disposing of the ownership of it.

(2) That further the Court of Review erred in law in holding that the profit or gain from sale of the debt was not liable to tax under section 11(a) of the Income Tax Act as derived from the carrying on or carrying out of an undertaking or scheme entered into or devised for the purpose of making a profit.

The respondent also appealed in respect of the dismissal of its appeal in respect of the first contention. The ground of appeal is as follows:

"That the Court of Review erred in law in holding that the Company's losses must be set off against the income derived from dividends earned from companies registered in Fiji before being able to be carried forward under Section 22 of the Income Tax Act."

Since the CIR's appeal to this Court was the first in point of time it is convenient to deal with his appeal first.

The Court of Review in considering the Trois Receivables had to consider whether the alleged gain or profit fell within the proviso (a) to section 11 of the Income Tax Act.

The proviso is as follows:

> Provided that, without in any way affecting the generality of this section, total income, for the purpose of this Act, shall include -
>
> "(a) any profit or gain accrued or derived from the 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 of 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;"

The Court of Review held that it did not fall within any of the three "limbs" of the proviso.

The three limbs are (a) that it was a business profit or gain from a dealing in property (b) that it was a profit or gain from sale of property acquired for the purpose of selling or otherwise disposing of it and (c) that it was profit or gain derived from the carrying out of any undertaking or scheme entered into or derived for the purpose of making a profit.

Before the Court of Review Mr Scott argued that the profit fell within all three "limbs." He now accepts the Court's ruling that it was not assessable under limb (a) and he does not now seek to argue that it was assessable under limb (c). He does, however, contend that the Court erred in not holding the profit was assessable under limb (b).

Mr. Scott complains that the Court of Review did not properly consider the issue of assessability of the alleged profit.

There are some grounds for that complaint as the issue was only dealt with briefly in the judgment.

The Court of Review stated:

> "Had it not been for the premium I would have thought there was no question of income. Just as a promise to pay is not income, no income arises from a promise to pay.
> See Cross v London Provisional Trust (1938) 1 AER 428. I do not think the appellant falls within the second limb of the proviso."

The reasons for the conclusion reached are not stated unless Cross's case is the authority. In that case it was held that the issue of funding bonds in place of interest was the issue of a capital asset and not the payment of interest. There was accordingly no receipt of income by the respondent company and the proceeds of sale of the funding bonds were not liable to tax. The bond was a promise to pay it in the future.

The head notes to Cross's case do not appear to properly reflect what was said in the judgment of Sir Wilfred Greene M.R. The Inspector of Taxes was not seeking to tax profit on the sale of the bonds which had a value but the value of the bonds when issued. He considered the bonds represented unpaid interest. It is not stated in the two judgments whether there was, as in the instant case, a profit or gain on the assignment of the bonds. I would assume there was no profit.

McKinnon L.J's remarks at pp. 435 & 436 were probably relied on by the Court to come to its conclusion. He stated:-

> "To which I would add, so as to include the further incident that occurs in this case, that, if the debtor cannot be said to have paid his creditor by giving him his promissory note, equally he cannot be said to have his debt when the creditor realises some money by assigning the promissory note to a third party. And, as the creditor does not receive payment from his debtor when he receives his promissory note, nor does "income arise" from that receipt, so equally he does not receive payment, or acquire income, when he sells the promissory note for what it will fetch."

If the Court acted on cross's case as authority for it holding that the profit or gain on the sale of the debt was not taxable I would agree with Mr Scott that it erred because the facts of that case do not fit the present case. The money owed by Trois was not taxable in the hands of the creditor. In Cross's case the issue of the funding bond was in place of payment of interest by the Brazilian Government.

Mr Scott has endeavoured to distinguish Cross's case because that case and cases cited in it refer to promissory notes and I.O.U's. The notes and I.O.U's are merely written records of promises to pay.

Mr Scott also relies on Harry Hall v Barron (1949) 30 T.C. 451 as authority for the proposition that profits on book debts are taxable. That case is distinguishable. It was a case where a tailor purchased from a Receiver for the debenture holders the debts of a former tailoring business. He realised a surplus on collection of the debts. It was held that collection of the debts were trading receipts and taxable.

However, since I have held that Cross's case is also distinguishable it is not necessary to consider that part of Mr Scott's argument any further.

It was common ground that the transaction of purchase and sale of the Trois Receivables did not form part of a series of transactions and was isolated.

The law is clear, however, and it was stated by Lord Russell in C.I.R. v Reinhold (1953) 34 TC 389, 394.

> The profit of an isolated transaction by way of purchase and resale at a profit may be taxable if a transaction is properly to be regarded as "an adventure in the nature of trade."

If the Court of Review considered whether the transaction was in the nature of trade or business it made no mention that it had done so in its judgment.

Mr Scott is not therefore challenging any finding of fact on that issue. It is in my view the main issue which had to be considered.

I have considered Mr Scott's submissions and am not persuaded that the Court of Review erred in holding that the gain or profit did not fall within the second limb. That decision in my view was correct although it is not clear how it came to that decision. The Court of Review did state that it was extremely doubtful whether in any real sense the debt could be said to have been acquired for the purpose of disposing of it. It gave no reasons for that doubt. The facts disclosed that the respondent had planned contemporaneously with the acquisition of the debt to resell the debt.

In my view the facts also clearly indicate that the transaction was not in the nature of trade or business.

The facts indicate that Stinson Pearce Holdings borrowed $2.7 million from the National Bank and passed that money over to the respondent a wholly owned subsidiary, which paid $2,697,769 to Barclay's Bank. The Trois Receivables

were then vested in the respondent. As part of the arrangement, on instructions of Mr Peter Stinson, who controlled both companies, the respondent then sold the Trois Receivables to Stinson Pearce Holdings Ltd for $3,302,000 resulting in a profit or gain for the respondent.

Those facts only have to be stated to indicate that the transaction was not in the nature of business or trade.

Stinson Pearce Holdings could have purchased the Trois Receivables but Mr Stinson wanted to do what was described as "window dressing" for the respondent. The transaction resulted in the respondent's accounts either showing a profit or more likely a reduction of its loss for the year. In the Consolidated Accounts of the Associated Companies there would have been neither a loss or a profit from the transaction.

Lord Denning in Petrotim Securities Ltd v Ayres (Inspector of Taxes) (1964) 1 W.L.R. 190 p. 194.

> " 'On the resale its figures might show a very large profit.' I need not say anything about the tax position of Ridge Securities because we are only concerned with Petrotim. 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.
>
> I will therefore dismiss the appeal."

The Petrotim case was concerned with the sale of Securities at gross undervalue to an associated company but Lord Denning's remarks in that case are apposite.

As the Trois Receivables were resold apparently for the amount of the debt, which was not payable on demand but over a period of time, the resale on or about the day

of purchase of a debt payable in the future must be deemed to be a resale at an overvalue. The proper way of determining the value of a debt payable in the future is to discount it. The nature of the debt did not permit of any accretion in value.

The Court of Review was in my view correct in its decision and accordingly the C.I.R's appeal fails.

I turn now to consider the Respondent's appeal which is concerned with the interpretation of section 22(1)(a) of the Income Tax Act which 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 -
>
> (a) be set off against his income from other sources for the same year;
>
> 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."

The issue is whether the word 'income' where it first appears means "total income", as defined in the Act and/or chargeable income. The Court of Review held that the word meant total income. The Respondent contends that in respect of a company it means chargeable income.

Neither Mr Handley nor Mr Scott have quoted any case which has dealt with the issue previously other than Review No. 7 of 1981 Fleischman's Ltd v Commissioner of Inland Revenue in which the Court of Review, similarly constituted as is the present Court, held that 'income' meant 'total income.' As those two industrious counsel have been unable to find another case to support their arguments I accept Mr Handley's comment that the issue does not appear to have been considered by the Courts.

Mr. Handley has presented a very interesting argument.

Under sections 6(1)(b) and 7(1)(e) basic and normal tax are payable on the "chargeable income" of a company.

Both sections use the term chargeable income and not total income.

Section 32(a) of the Act which is in Part V "ascertainment of Chargeable Income" provides as follows:

> "32. For the purposes of this Act, the chargeable income of a company shall be:
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> (a) in respect of a company other than a non-resident company, the total income of the company for that year accruing (sic) in or derived from Fiji."

Mr Handley contends that the two expressions "total income" and "chargeable income" are interchargeable so far as a resident company is concerned.

Part IV of the Act at the relevant time was in two parts headed "(A)Amounts to be included in arriving at total income," and "(B) Amounts to be excluded in arriving at total income."

Proviso (f) in section 11, which is in part A, includes dividends paid or credited in that year.

Section 17(1)(37) however, which is in part B, exempts from basic and normal tax any dividend from a company incorporated in Fiji received by or accrued to a resident company. Income from such dividends, being exempt from basic and normal tax which are the only taxes a resident company pays, Mr Handley argues, is not chargeable income of a resident company and ergo not part of <u>its</u> total income.

Section 22(1)(a) allows a set off of losses against income from other sources but as Mr Handley points out the legislature has not defined in clear terms the income there referred to.

Subsection (b) of Section 22(1) enables a carry forward loss to be set off against "what would otherwise have been his total income." Mr. Handley argues that 'income' in (a) will have the same meaning i.e. "total income" but since "total income" and "chargeable income" so far as a company is concerned are interchangeable terms,(Section 32(a)) dividends from Fiji Companies are not part of the respondent's chargeable or total income and losses can not be set off against income from such dividends.

Mr. Handley also points out that the Act has not been consistent in its use of language. Section 11(f) makes all dividends part of total income. Section 17(1) provides that some dividends will not be chargeable to tax but section 32(a) states that a company's chargeable income shall be its total income.

Mr. Handley argues that the Act as a whole must be read. Section 11(f) enacts a prima facie rule and section 17(1)(37) creates a limited exception. Where the exception applies, and it can only apply to a resident company, the dividends in question do not in the result form part of its total or chargeable income. He points to the headings to Part IV to support this conclusion and to section 13 of the Interpretation Act which is as follows:-

> "13. When a written law is divided into Chapters, Parts, titles or other sub-divisions, the fact and particulars of such division and subdivision shall, with or without express mention thereof in such written law, be taken notice of in all courts and for all purposes whatsoever."

Mr Scott devoted most of his argument on this issue to the weight which should be given to the heading to Part B, as it was at the relevant time and which I repeat, "AMOUNTS TO BE EXCLUDED IN ARRIVING AT TOTAL INCOME."

The Court of Review in considering Part B compared Part A and the sections thereunder, 11 to 15 both inclusive, with Part B. The Court pointed out that all those sections in Part A could be said to relate to matters to be included in "total income."

In Part B, however, sections 16 to 23 inclusive, the Court found the position to be different. As regards section 16 which deals with the power of the Minister of Finance to exempt various types of income the Court stated:-

> "I would have thought it a misdirection to regard those matters as being excluded from total income."

It appears to me that the section provides a power to exclude what would otherwise be taxable income from the definition of total income. If that were not the case the section would conflict with section 6(1)(a) which is as follows:-

> "6 - (1) Notwithstanding the other provisions of this Act, there shall be assessed, levied and paid a tax to be known as basic tax at the rate of 2.5 cents in each complete dollar for each year of assessment -
> (a) on every dollar of total income derived during the year."

By virtue of section 16 an exemption thereunder excludes income from the definition of "total income". Otherwise section 6 would have had to provide that "Subject to any exemption granted under the provisions of this Act," or words to that effect. Section 6 commences however by making the other provisions of the Act subject to the section.

In considering section 17 which states that some 48 classes of income shall not be chargeable the same comments apply, unless those classes are excluded from "total income" there would be conflict with section 6.

By contrast section 7(1) is made subject to the other provisions of the Act. Nevertheless, if the heading to Part B is factual, as I believe it is, section 17(1)(37) refers to income excluded from total income.

The Court of Review in considering section 17(1)(37) stated there was nothing there to say that dividends were to be omitted in calculating total income. That statement ignores the clear heading to Part B which the Court also ignored in considering section 22(1) because it considered the wording of that section was clear and required no assistance from the heading. The Court relied, inter alia, on Fletcher v Birkenhead Corporation (1907) I KB 205 and R v Surrey (North Eastern Area Assessment Committee) (1947) 2 AER 276, p.279 where Lord Goddard CJ in the latter case in referring to the first mentioned case said:-

> " It seems to me clear that the House of Lords and the Court of Appeal emphasised that reference can be made to headings only where the construction is doubtful."

Of more importance, however, the Court in considering section 17(1)(37) did not consider section 6. Had it done so it should have come to the conclusion that such dividends were not part of a resident company's total income.

Further consideration of section 32 of the Act should have indicated that such dividends were not part of the resident Company's total income.

The Court of Review considered that the meanings of sections 16 to 23 inclusive were clear and that the clear meanings must prevail over the meaning suggested by the heading. It quoted the words of Scott L.J. in Croxford v Universal Insurance Company (1936) 2 KB 253, 28 as follows:-

> " Where the words of an Act of Parliament are clear, there is no room for applying any of the principles of interpretation, which are merely presumptions in cases of ambiguity in the statute."

While the words in section 22(1) were on the face of them quite clear the interpretation placed on them by the Court, which treated the items as exemptions from "total income" resulted in a conflict with section 6. It failed, as I indicated earlier to appreciate that the literal translation conflicted with section 6 of the Act. It was, therefore, necessary to call in aid the quite clear words of the heading. The income exempted under Part B was not only exempted from tax but for the purposes of the Act was not part of total income as defined and the Court should have so held.

So far as the respondent company was concerned when the Court came to consider section 22, it should, as Mr Handley suggested, have considered the Act as a whole and not limited its consideration to section 22(1)(a). The Court stated:-

> "The act clearly says in section 22 that losses shall be set off against income from other sources."

The Court did not apply its mind to the question whether "income" in this section meant "total income", and also chargeable income. Had it done so it would have appreciated that the Act, in some respects, treated a resident Company differently for tax purposes. What was total income as defined in section 11 for an individual was not necessarily total income of a resident Company.

Dividends referred to in section 17(1)(37) are not taxable in the hands of a resident company. They are not part of the chargeable income of the company and are by operation not only of the section but also section 32 not any part of that Company's total income.

While Mr Scott argues that the proviso to section 22(1) is not relevant and the Court of Review appears to have ignored it, the proviso does indicate that the income which is being

considered is the "chargeable income" of the taxpayer, which is "total" so far as an individual is concerned and "total" in a limited sense so far as a resident company is concerned.

Where a loss is made in a transaction which, if profitable, would not be liable to tax, it is right and proper that that loss not be set off against profits from other transactions.

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.

The respondent's objection to the C.I.R.'s assessment of its income for year ended 31st January 1979 which was allowed in part by the Court of Review should have been allowed also as regards the setting off of losses under section 22(1)(a).

I allow the appeal and direct that the assessment dated 14th January, 1983 be amended to allow of setting off of losses previously incurred by the company against the chargeable income of the respondent.

The respondent is to have the costs of the CIR appeal and its appeal to this Court and its costs of appeal to the Court of Review.

R.G. Kermode

R.G. Kermode

J U D G E

SUVA,

14th June, 1985