

COMMISSIONER OF INLAND REVENUE

v

SAMOA PRINTING AND PUBLISHING COMPANY LIMITED

Supreme Court Apia
25, 29 September 1972
Rothwell CJ

COMPANY LAW (Income tax) - Income Tax Ordinance 1955 s 57(3) - Claim by Company to carry forward losses incurred in previous years - Claim only allowable if shareholders substantially the same at both balance dates - Where the vendors of the total shareholding of the Company under an Agreement for Sale of Shares were held to have retained both the legal and the beneficial ownership of the shares pending completion of payment under the Agreement and registration of transfers the Company was entitled to carry forward losses incurred prior to the date of sale.

CONTRACT (Sale of total shareholding of private Company pursuant to Agreement for Sale of Shares) - Whether vendors trustees for purchasers - Agreed Statement of Facts setting out terms of Agreement as providing for a down payment and payment of the balance of the purchase price by equal annual instalments over a ten-year period and stipulating dates for first and last payments; transfers of shares to be executed by vendors and retained by them until balance paid "as if they were in fact registered mortgagees of the purchasers"; or the vendors might require the purchasers to execute mortgages of the shares; and a provision that as "directors and sole owners of the Company" the purchasers would not mortgage or otherwise encumber the shares except to the Bank of Western Samoa -

Held, that the vendors remained the legal and beneficial owners of the shares pending completion of payment under the Agreement and registration of the share transfers on the Company share-register:
Avon Downs Proprietary Limited v The Federal Commissioner of Taxation (1949) 4 AITR 195, In re Wala Wynaad Indian Gold Mining Company (1882) 21 Ch D 849, Hawks v McArthur [1951] 1 All ER 22, applied.

CASE STATED pursuant to Regulation 21 of the Income Tax Regulations 1956 to determine whether the ruling of the Commissioner of Inland Revenue pursuant to s 57(3) of the Income Tax Ordinance 1955 disallowing certain losses claimed by the defendant was correct.
Ruling of Commissioner held incorrect.

Slade for plaintiff.
Clarke for defendant.

Cur adv vult

ROTHWELL CJ. This was a case stated under the Income Tax Ordinance 1955 arising from an objection to the assessment made by the Commissioner on the 19th day of May, 1970 under which the Commissioner had declined to allow losses prior to 30 December, 1966 to be carried forward and taken into account in his assessment. The question set out in the case stated is whether the Commissioner's ruling under section 57(3) of the

Income Tax Ordinance 1955 is correct.

An examination of the facts discloses a most extraordinary state of affairs. The objector (to whom I shall hereafter refer as the Company) appears to have had no register of members; at all events no such register was put before the Court. The information therefore with regard to shareholding must be gleaned from the various annual returns and other sources placed before me by way of an Agreed Statement of Facts, which were said to be common ground between counsel. The Company had a total capital of £6,000 divided into 6,000 shares of £1 each and until the 23rd day of September, 1966 these shares were held by four shareholders and the estate of a deceased shareholder (all of whom will be collectively referred to in this judgment as the vendors). On 23 September, 1966 the vendors entered into an Agreement with Aitken Fruean and Rudolf Henry Ott both of Apia, Printers (who will for convenience hereinafter be referred to as the purchasers) for the sale of the total shareholding of the Company at the total price of £15,000 to be paid by a deposit of £1,000 on execution of the Agreement and by annual payments of £1,400 each until the 1st day of September, 1976. There were certain provisions for interest which are not relevant to these proceedings. Each of the purchasers was to take half of the shareholding agreed to be sold. The Agreement provided that while any money should remain owing under it the purchasers "as directors and sole owners of the Company" would not mortgage or otherwise secure or encumber the property of the Company to any persons other than the Bank of Western Samoa with certain limitations set out in the Agreement. There was a further provision that whilst any money remained owing the purchasers would not transfer their shares or any of them to any other person without previous written consent of the vendors.

The provision that gives rise to the difficulty in interpreting this Agreement and deciding what effects flow from it is contained in clause 7 which provides that "the vendors will without undue delay execute transfers to the purchasers in equal shares of the vendors' respective shareholdings in the Company PROVIDED HOWEVER that the vendors shall be entitled to retain possession of such transfers and any certificates issued in pursuance thereof while any moneys shall remain owing under this Agreement as if they were in fact registered mortgagees of the purchasers."

A further somewhat cryptic provision was contained in clause 10 as follows:-

Upon the execution of transfers of shares in favour of the purchasers the purchasers shall if required by the vendors execute in favour of the vendors individually valid mortgages over the shares by them respectively transferred to the purchasers.

This appears to be in conflict with the provisions of clause 7 which entitled the vendors to retain possession of the executed transfers while any moneys remain owing under the Agreement. In terms of the Agreed Statement of Facts put before the Court the transfers were in fact and still are in the hands of the vendors and no transfer has been registered with the Company in the manner required by the Companies Act and the Articles of Association of the Company.

The purchasers, however, appear to have acted as if they were shareholders of the Company as seems to be contemplated by the Agreement in the provision cited above describing them as "directors and sole owners of the Company". As I have already stated it is assumed that the Company has no share-register. The annual returns until September, 1967 show the vendors as having been shareholders until the 23rd day of June, 1966 on which date "the meeting agreed to transfer to A.L. Fruean and R. Ott all shares in the Company, viz., £3,000 each". The return then showed 6,000 shares held by the vendors and also in the second column 3,000 shares held by each of the purchasers. The column relating to date of registration of transfer is blank. A year later an annual return was filed showing the shareholders as A.L. Fruean 3,000 and R.H. Ott 3,000. An identical return was filed also in 1968. On 23 November, 1970 two returns were filed (one apparently being for 1969) and in each case the

shareholders were listed as "A.L. Fruean and Family" 6,000. Under the heading of particulars of directors the same entry is made showing the directors as "A.L. Fruean and Family." There is no information on the annual return showing how the shares in the name of R.H. Ott got into the name of A.L. Fruean and Family, nor is there any information as to the constitution, number, ages, sexes and occupations of the family. The final return before the Court dated 18 October, 1971 shows the shareholding as "E.F. Paul, G.T. Jackson, I.H. Carruthers as vendors, A.L. Fruean and Family under contract for purchase 6,000". The directors are still shown as A.L. Fruean and Family. Again there is no information as to how any change in shareholding had taken place.

The Articles of the Company provide in Article 19, "the transferor shall be deemed to remain a holder of the share until the name of the transferee is entered in the register of members in respect thereof."

The Articles further provided regarding directors as follows:-

- 82. The number of directors shall be not less than 2 and not more than 5.
- 86. The qualification of a director shall be the holding of 500 shares in the capital of the Company.

A further document of some interest on the Companies Office File is what purports to be a Debenture to the Bank of Western Samoa. The execution of the Debenture is verified in the usual way by a declaration by the Acting Secretary testifying that he was present with "Aitken Fruean and Rudolf Henry Ott, two directors of the said Company, on the 16th May, 1967 and saw the common seal of the Company affixed." The document itself is a copy but has the names of A.L. Fruean and R.H. Ott typed as witnessing the execution by the affixing of the seal and there are also signatures which appear to be the same signatures as those of the purchasers to the Agreement of Sale of Shares. It is no part of the Court's function to speculate in these proceedings on the effect of this document.

Upon consideration, therefore, of the Agreed Statement of Facts and the documentary evidence available it appears clear that no transfer has ever been legally registered to take the shares out of the names of the vendors, but nevertheless the purchasers have acted throughout as if they were in fact shareholders of the Company in place of the vendors and have further acted as if they were lawfully qualified and appointed directors and have pledged the assets in the Company within the limits authorised by the Agreement for Sale and Purchase of Shares.

It is now necessary to examine the legal effect of these strange events. The Income Tax Ordinance 1955 section 57(3) relating to a taxpayer's claim to set off against profits, losses made in previous years, has this limitation:-

Notwithstanding anything in the foregoing provisions of this section, if in any year of assessment any taxpayer, being a company, claims to carry forward any loss made by it in any former year, the claim shall not be allowed unless the Commissioner is satisfied that the shareholders of the company on the balance date of the company for the year to which the loss claimed is to be carried forward were substantially the same as the shareholders of the company on the balance date of the company for the year in which the loss was incurred. For the purposes of this subsection the shareholders of the company at any date shall not be deemed to be substantially the same as the shareholders on any other date unless, on both such dates, not less than three-fourths of the paid up capital of the company was held by or on behalf of the same persons, nor unless, on both such dates, not less than three-fourths in nominal value of the allotted shares in such company were held by or on behalf of the same persons.

The manner of shareholding is covered by the words "by or on behalf of" which is taken directly from the New Zealand legislation; and a substantially parallel provision using the words "beneficially held"

appears in Australian Tax legislation. The only authority submitted as to the meaning of the word "held" which appears in the Ordinance and both Acts is Avon Downs Proprietary Limited v The Federal Commissioner of Taxation (1949) 4 A.I.T.R. 195, a judgment of the High Court of the Commonwealth where the headnote succinctly states that, "shares are not 'held' by a person within the meaning of (the Act) unless his name is upon the register of members as a holder of those shares." In arriving at that decision His Honour Mr Justice Dixon adopted the judgment of Chitty J. in In re Wala Wynaad Indian Gold Mining Company (1882) 21 Ch.D. 849. In the Avon Downs case there was an agreement for sale of shares and the purchase money in respect of the shares concerned was made payable on the day of the agreement and was in fact paid on that day, but owing to a series of unfortunate circumstances, the relative transfer of shares remained unregistered. Mr Justice Dixon at page 204 has this to say:-

Beneficially the 258 shares belonged to Jack L. Vivers, but until his transfer was registered and his name placed on the share register he could not be said to "hold" them within the meaning of s. 80(5). They were "held" by G.A. Vivers; but he was a trustee for Jack L. Vivers and therefore did not hold them beneficially.

Mr Slade referred me to the case of Hawks v. McArthur [1951] 1 All E.R. 22, which was not a taxation case, but was a case in which the decision had to be made as to whether the vendor or the purchaser in respect of a sale of shares was the holder in order to determine whether a charging order could attach to the shares in respect of which the transfer had not been registered. The headnote states:-

F and R having paid to M the full consideration for the shares had obtained equitable rights therein and as their rights accrued earlier than the equitable right of the plaintiff under the charging order their rights must prevail over his claim.

The point in that decision is that the vendor under a transfer of shares, who has been paid the full consideration, is a trustee for the purchaser of the beneficial interest in the shares. The principle is clear that a vendor who has been paid all that is due to him has no further interest and although he still nominally holds the legal estate pending the registration of a transfer is a constructive trustee for the purchaser in respect of all rights under the shares.

In the present case the document dealing with the shares was not a transfer but an Agreement to sell and it provided instead of the usual full cash payment a programme of payment by instalments over a period of ten years. At the time of the assessment only the deposit and three annual payments totalling £5,200 had been paid, and there was a balance of £9,800 still outstanding. These facts all appear from the Agreement itself, and that is an answer to Mr Slade's submission that what the Court should consider is the material which was available to the Commissioner when he made his assessment.

From what has already been said it is clear that the shares were "held" by the vendors both at the time that the loss was incurred and at the time that the assessment was made by the Commissioner and therefore the only support for the Commissioner's application of section 57(3) must flow from a finding that at the time of his assessment the shares were held by the vendors but "on behalf of" the purchasers and that such an alteration in the shareholding justified his refusal to allow losses to be taken into account. The only basis for such a decision would be a finding that there was a constructive trust and all the authorities quoted relate to cases in which the full consideration had been paid and the vendors had accordingly ceased to have any pecuniary interest in the shares and must therefore logically apart from any questions of law be considered trustees for the purchaser until the passing of the legal estate made the purchaser the full legal owner.

This question was contemplated when the Agreement was executed

because clearly the right vested in the vendors under clause 7 to hold up registration of the transfers until payment of the total purchase price is on the basis that they would hold the share transfers and the shares on their own behalf as security until full payment had been made. There was £9,800 still to come. The only departure from that principle is contained in clause 10 which could only be brought into effect if the vendors waived their rights under clause 7 and in that event the transfers would be registered and a mortgage given to the vendors securing the balance of purchase price still unpaid.

On the Agreed Statement of Facts it is clear that the legal estate in the shares never passed and under the Agreement for Sale of the shares I am unable to find any factors which would create a trust having the effect of making the legal ownership of the shares subject to a constructive trust as to the beneficial ownership in favour of the purchasers.

Accordingly, I hold that the provisions of section 57(3) as to shareholdings at the two relative dates being substantially the same are established and the answer to the question posed in the case stated is "NO".

Costs allowed to the objector \$21.00.

NOTE

An appeal by the Commissioner of Inland Revenue against this decision was allowed by the Court of Appeal 1 June 1973, post p. 63.