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31, 1952

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P.C.A. No. 23 of 1951.

In the Privy Council.

UNIVERSITY OF LONDON W.C.1. 21 JUL 1953 INSTITUTE OF ADVANCED STUDIES OF CEYLON

ON APPEAL

THE SUPREME COURT OF THE ISLAND

BETWEEN:

THE ATTORNEY GENERAL OF CEYLON

(Respondent) *Appellant*

and

CHARLES WILLIAM MACKIE (Junior) and JAMES
CRAIB MACKIE (both of Colombo and Executors of the
last Will and Testament of Charles William Mackie
deceased (Applicants) - - - - - Respondents.

CASE FOR THE RESPONDENTS.

RECORD.

1. This is an Appeal, by leave of that Court, from a Decree of the Supreme Court of Ceylon dated the 25th May, 1950, allowing an Appeal by the Respondents from an Order of the District Court of Colombo dated the 31st August, 1949. The last mentioned Order was pronounced upon an Appeal by the Respondents under Section 38 of the Estate Duty Ordinance (Chapter 187 of the Legislative Enactments of Ceylon) from a determination by the Commissioner of Estate Duty of the value of certain shares forming part of the estate of Charles William Mackie deceased (hereinafter called "the deceased").

10 2. The sole question for determination upon this Appeal is what, on a true interpretation of the relevant portions of the said Ordinance, and on the facts of this case, was the value for Estate Duty purposes as at the date of the death of the deceased on the 7th September 1940 of 5,000 Management Shares in a Company called "C. W. Mackie & Company Limited" (hereinafter called "the Company") which formed part of his estate in Ceylon.

3. The Company was incorporated on or about the 7th January, 1922, under the Ceylon Joint Stock Companies' Ordinance, 1861, as a company limited by shares. Its principal object was to acquire and carry on as a going

RECORD.
 p. 33J.
 p. 36, ll. 17
 et seq.
 p. 58, ll. 35
 et seq.
 p. 64, ll. 19
 et seq.
 p. 72, ll. 18
 et seq.
 p. 87, l. 22
 p. 274, ll. 28
 et seq.
 p. 34, ll. 36,
 37, 38.

concern the business of Merchants and Commission Agents theretofore carried on by the deceased; the Company duly acquired the said business and carried on business thereafter as a dealer in rubber on its own account. The said business was necessarily highly speculative; not only was it carried on on narrow margins, but there were also violent fluctuations in the market price of the commodity in which it dealt. It was rendered still more speculative by the policy adopted by the Management of the Company (which was at all times under the control of the deceased as Life Director who had extraordinary powers conferred upon him by Articles 92 to 95 of the Company's Articles of Association) and by the restrictions upon the export of rubber imposed by the Law of Ceylon under the Rubber Control Ordinance (Chapter 300 of the Legislative Enactments of Ceylon), the Rubber Control Ordinance, No. 63 of 1938 (which replaced the former Ordinance as from the 1st January 1939), and Regulations made under those Ordinances respectively. 10

4. The initial capital of the Company (which remained unchanged at the death of the deceased and was at all material times fully issued) was Rupees 1,000,000 divided into 19,800 Cumulative Preference Shares of Rs. 50 each and 5,000 Management Shares of Rs. 2 each. Under the Memorandum and Articles of Association of the Company the said Preference Shares conferred the right to a fixed Cumulative Preferential Dividend at the rate of 8 per cent. per annum on the capital for the time being paid up or credited as paid up thereon, and the right in a winding up to payment of capital and arrears of dividend whether declared or undeclared at the commencement of the winding up in priority to the Management Shares, but did not confer any further right to participate in profits or assets. The said Management Shares conferred on the holders thereof, rateably and in proportion to the number of such shares held by them respectively, the right to all profits or other moneys of the Company available for dividend which it should from time to time be determined to distribute and which should remain in each year after making such provision as the Directors should think fit for reserve or depreciation and after paying or providing for the payment out of such profits or other moneys (a) of the remuneration payable to the Directors for that year under the Articles of Association of the Company for the time being and (b) of a cumulative preferential dividend at the rate of eight per cent. per annum on the capital paid up on such of the said Preference Shares as should have been issued, and the right to the surplus assets which in a winding up of the Company should remain after paying off the whole of the Company's paid up capital and any arrears of preference dividend. Under Article 83 of the Company's Articles, on a show of hands every member present in person had one vote, and on a poll every member present in person or by proxy had one vote for every Preference Share and one vote for every Management Share held by him. 20 30 40

p. 255, ll. 29
 et seq.
 p. 259, ll. 17
 et seq.

p. 255, ll. 29
 et seq.

p. 272, l. 43.

p. 265, ll. 9
 et seq.

5. The Articles of the Company contained in Articles 38 to 50 (a) severe restrictions upon the right to transfer shares in the Company freely, both as regards the selection of the transferee and the price to be paid, which in default

of agreement was to be the fair value thereof as fixed by the Company's auditors (b) a right for the holders for the time being of the nine tenths of the issued capital to acquire any shares not held by them compulsorily at the said fair value and (c) restrictions upon the right of a Member to carry on or be interested in a business competing with that of the Company either whilst a Member or within 5 years after termination of Membership.

RECORD.

p. 267, ll. 1 et seq.

p. 267, ll. 29 et seq.

p. 268, ll. 1 et seq.

6. The net profits and losses made by the Company from its inception to 1940 in each financial year (which coincided with the calendar year) are shown in the following table:—

					Rs.	Rs.
10	Profit	1922	...	...	371,047	
	Profit	1923	...	...	299,454	
	Profit	1924	...	...	299,740	
	Profit	1925	...	...	1,533,460	
	Profit	1926	...	...	937,658	
	Loss	1927	...	...		70,735
	Loss	1928	...	...		52,567
	Loss	1929	...	...		12,667
	Loss	1930	...	...		774,680
20	Loss	1931	...	...		390,573
	Loss	1932	...	...		503,082
	Profit	1933	...	...	443,161	
	Profit	1934	...	...	253,712	
	Loss	1935	...	...		281,907
	Profit	1936	...	...	97,392	
	Loss	1937	...	...		40,690
	Profit	1938	...	...	149,846	
	Profit	1939	...	...	787,641	
	Profit	1940	...	...	501,878	

p. 34, l. 41.
p. 70, ll. 10 et seq.

p. 100, ll. 14, 15, 16.

p. 126, ll. 3 et seq.

p. 165, ll. 10 et seq.

p. 57, ll. 30 et seq.

p. 97, ll. 4, 5, 41 et seq.

p. 98, l. 1.

p. 366.

p. 32, ll. 35, 36.

p. 364, ll. 28 et seq.

p. 351.

p. 363, ll. 30, 31, 32.

30 The profits made in the years 1938, 1939 and 1940 were abnormal Profits due to War conditions. No Directors' fees had been paid for many years. At all material times the Company was financed by a loan from its Bankers guaranteed by the deceased.

7. At the date of the death of the deceased the dividend upon the said Preference Shares had been in arrear since the 1st January 1930, although payment for the years 1930 to 1932 inclusive had been recommended by the Directors on the 5th September 1940. No dividends had been paid upon the said Management Shares since the year 1926.

40 8. The Respondents are the Executors of the deceased, who died at Aberdeen in Scotland on the 7th September 1940, that is to say at the height of the Battle of Britain, the most critical stage of the 1939-45 War, at a time when the

international outlook was at its most uncertain. His estate included:—

(a) 9,201 of the said Cumulative Preference Shares in the Company; and

(b) 5,000 of the said Management Shares in the Company.

9. Section 20 sub-section (1) of the said Estate Duty Ordinance provides for the valuation of property for the purpose of Estate Duty as follows:—

“ 20 (1) Subject to the provisions of sub-section (2) the value of any property shall be estimated to be the price which, in the opinion of an Assessor, such property would fetch if sold in the open market at the time of the death of the deceased; and no reduction shall be made 10 in the estimate on account of the estimate being made on the assumption that the whole property is to be placed on the market at one and the same time; PROVIDED that where it is proved to the satisfaction of an Assessor that the value of the property has been depreciated by reason of the death of the deceased, the Assessor, in fixing the price, shall take such depreciation into account.”

Sub-section (2) of the said Section 20, referred to in Sub-section (1) relates to the inclusion in the value of any property of the amount of any income thereof accrued due, but not received by the deceased, prior to his death, and does not appear to be material for the purposes of this Appeal. 20

By sub-section (6) of the same Section (added by Ordinance No. 8 of 1941, which came into operation on the 26th April 1941) it is provided as follows:—

“ (6) (a) Where the property to be valued consists of shares (not being preference shares) in any company which by its articles restricts the right to transfer its shares or which is a company controlled by not more than five persons, and the Commissioner is satisfied that the shares have not, within the period of twelve months immediately preceding the death of the deceased, been quoted in the official list of a recognised stock exchange in the United Kingdom or in a list of a like nature issued in Ceylon by any association of brokers approved by the 30 Financial Secretary for the purposes of this sub-section, the Commissioner may direct that the principal value of such shares for the purposes of this Ordinance shall not be ascertained in the manner provided by sub-section (1) but shall be ascertained by reference to the value of the total assets of the Company.

(b) For the purposes of paragraph (a) “ company controlled by not more than five persons ” means a company in which:—

(i) the number of shareholders is not more than fifty; and

(ii) more than half the total shares issued are held by not more than five persons, their wives, or minor children, either directly or 40 through nominees;

“ preference share ” means a share the holder of which is entitled to a dividend at a fixed rate only;

“ share ” includes any interest whatsoever in a company, by whatsoever name it is called, analogous to a share ;

“ value of the total assets of a company ” means the principal value, ascertained in accordance with the provisions of sub-section (1), of all the assets of the company as a going concern, including goodwill, after deducting therefrom :—

- 10
- (i) the par or redemption value, whichever is the greater, of any debentures, debenture stock and preference shares of the company ;
 - (ii) all debts of the company incurred or created bona fide for consideration in money or money's worth ;
 - (iii) such sum as on a just and fair computation represents any future or contingent liabilities of the company or any liabilities thereof which are uncertain in amount ;
 - (iv) the amount of any reserve fund separately invested which is bona fide intended to be applied in payment of pensions to employees or otherwise for the benefit of them or their dependants or relatives and in no other manner.”

10. On the 22nd December, 1942, Respondents delivered to the Commissioner of Estate Duty in accordance with the requirements of Section 29 of the said Ordinance a declaration of the property of the deceased in which the said 5,000 Management Shares were valued at Rs. 4,925. p. 10, ll. 28
et seq.

11. A provisional notice of assessment dated the 15th February, 1943, which substantially accepted this figure, was superseded by an additional notice of assessment dated the 21st April, 1944, in which the Assessor valued the said shares at Rs. 300 each, a total of Rs. 1,500,000. p. 11, ll. 3
et seq.

12. The Respondents in accordance with Section 35 (1) of the said Ordinance delivered to the Commissioner of Estate Duty a Notice of Objection dated the 19th May, 1944, in which they objected (inter alia) to the said increased assessment of the said Management Shares upon the grounds that such shares must be valued in terms of the said Section 20 (1), that is to say, the market value less depreciation by reason of the death of the deceased, that the value of such shares could only be based upon the net value of the Company's assets at the date of death after providing for the value of all the Preference Shares and that they were prepared to accept a valuation of Rs. 40.6188 per Management Share as certified by the Auditors of the Company, less a sum of Rs. 10.6188 per share for depreciation due to the death of the deceased, namely Rs. 30 per share or Rs. 150,000 in all. They further indicated that no goodwill value attached to these shares at the date of death. p. 11, ll. 19
et seq.

13. The said valuation of Rs. 40.6188 per Management Share was upon the basis of a Balance Sheet valuation of the Company's Assets less liabilities, but without including any amount for goodwill. p. 216, ll. 27
et seq.
pp. 363-367.

p. 12, ll. 14
et seq.

14. The Commissioner of Estate Duty by a letter to the Proctors of the Respondents dated the 20th May 1946, notified them of his determination to maintain the previous assessment subject to a reduction in value of the said Management Shares from Rs. 300 to Rs. 250 each.

pp. 10-13.

15. The Respondents appealed by way of Petition to the District Court of Colombo from the said determination of the Commissioner on the 14th June 1946, upon the grounds set out in the said notice of objection, and also upon the ground that the provisions of sub-section (6) of the said Section 20 did not apply as they were not in force at the date of the death of the deceased.

pp. 26 & 27,

16. The Appellant by his Answer to the said Petition dated the 20th 10
January 1948, denied that no goodwill had attached to the said Management Shares at the death of the deceased, and denied as a matter of law that the provisions of the said sub-section (6) of Section 20 did not apply to the valuation of such shares.

p. 228, ll. 26
et seq.
p. 230, ll. 30
et seq.

17. The methods by which the Appellant valued the said shares (which were only disclosed for the first time at the hearing before the District Court of Colombo after the Respondents' case was closed and which were never put to their witnesses in cross-examination) were:—

p. 81 et seq.,
p. 217, ll. 4
et seq.

(a) A capitalisation of the average profits of the Company (calculated after deducting an 8 per cent. dividend upon the said Preference 20
Shares but before placing anything to reserve or making any deduction for taxation) over the four and two thirds years immediately preceding the death of the deceased at 15 per cent.; or alternatively

p. 106 et seq.
p. 127, ll. 19
et seq.

(b) A capitalisation of a weighted average of the profits of the Company for each of the five years immediately preceding the death of the deceased (calculated after deducting income tax each year and after deducting from the average an 8 per cent. dividend upon the said Preference Shares and an appropriation of Rs. 30,000 to reserve) at 16 per cent.

p. 92 et seq.,
p. 143, ll. 20
et seq.

p. 144, ll. 32
et seq.

The witnesses who respectively put in evidence valuations based on the said 30
two methods admitted in cross-examination that their valuations could not be justified except upon the assumption that any purchaser of the said Management Shares would also purchase a number of Preference Shares in the Company sufficient to give him at least one tenth of the voting rights in the Company in order not to be liable to expropriation under Article 46 of the Company's Articles of Association.

p. 267, l. 1.

pp. 196-206.

18. The District Court of Colombo (Goonsekere A.D.J.) by its judgment delivered on the 31st August 1949 accepted the methods of valuation of the said shares for which the Appellant contended and held that the value of the said Shares was Rs. 250 each, a total of Rs. 1,250,000, and ordered that the 40
Respondents should pay to the Appellant the costs of the inquiry before it.

19. From this decision the Respondents appealed to the Supreme Court by Petition of Appeal dated the 9th September 1949. The Supreme Court (Jayetileke, C.J. and Gratiaen, J.) delivered its judgment on the 22nd May 1950.

Jayetileke, C.J., after observing that the answer to the questions before the Court did not depend upon the credibility of the witnesses, and that the learned Additional District Judge had in some respects failed to appreciate the evidence, held that each of the methods of valuation relied upon by the Appellant was fallacious when applied to a speculative business, and emphasised the complete uncertainty of the Company's prospects at the critical period of the War when the deceased died. He also rejected the "weightage method" as inapplicable where there is "no trend of profits" and as in any case requiring the exclusion from consideration of all abnormal and war profits. Gratiaen, J., similarly held that neither of the methods of valuation relied upon by the Appellant was properly applicable to the valuation of shares in a "highly speculative business whose past history lacks evidence of any steady earning power," and that the "balance sheet method" adopted by the Respondents was in all the circumstances "the most appropriate method to adopt because it is not possible to arrive at a logical assessment of the future maintainable profits" of the Company. The Supreme Court accordingly allowed the Appeal of the Respondents and (the Respondents not pressing "their earlier contention that the figure of Rs. 40.6188 per share should, in terms of the proviso to Section 20 (1) of the Ordinance, be further reduced by reason of Mackie's death" or claiming "depreciation on account of the restrictions contained in the Articles of Association") fixed the value of the said shares at Rs. 40.6188 per share and gave judgment for the Respondents in the sum of Rs. 166,929.57 (being the Estate Duty overpaid by the Respondents) with interest together with costs there and below.

20. Against the said Judgment of the Supreme Court this Appeal is now preferred, final leave so to do having been granted by the Supreme Court on the 29th June 1950.

30 21. The Respondents submit that this Appeal should be dismissed for the following among other

REASONS.

(1) BECAUSE neither of the methods of valuation of the 5,000 Management shares in the Company adopted by the Appellant is appropriate in the case of a company, such as the Company, which has not been earning steady profits.

(2) BECAUSE neither of the said methods is appropriate in the case of a company, such as the Company, engaged in a highly speculative business.

RECORD.

pp. 207-213.

pp. 214-245.

p. 216, l. 20.

p. 216, l. 25.

p. 225, l. 5.

p. 228, l. 32.

p. 225, ll. 18

et seq.

p. 228, ll. 35

et seq.

p. 242, ll. 18

et seq.

p. 242, ll. 20

et seq.

p. 245, ll. 8

et seq.

p. 229, l. 4.

p. 245, l. 22.

p. 250.

(3) BECAUSE neither of the said methods makes any allowance for the fact that the Profits earned by the Company in 1938, 1939 and 1940 were abnormal profits due to war conditions.

(4) BECAUSE both the said methods proceed on the erroneous assumption that there were materials available to a prudent investor on the 7th September 1940, from which he could assume that the risks and hazards of speculation had been eliminated from the affairs of the Company.

(5) BECAUSE both the said methods ignore the critical 10 nature of the world situation on the 7th September 1940.

(6) BECAUSE both the said methods proceed on the erroneous assumption that a valuable goodwill had attached to the business of the Company.

(7) BECAUSE neither of the said methods makes any allowance for the outstanding unpaid preferential dividends.

(8) BECAUSE the first of the said methods makes no allowance for reserves.

(9) BECAUSE the witnesses who respectively submitted valuations based on the said methods admitted that their 20 valuations could not be justified except on the assumption that the purchaser of the said shares would purchase a sufficient number of Preference shares in the Company to avoid the risk of expropriation under Article 46 of the Company's Articles of Association.

(10) BECAUSE there is no justification in law for making the assumption mentioned in (9) above.

(11) BECAUSE even on the assumption mentioned in (9) above the values put upon the said shares by the two witnesses for the Appellant were excessive in amount. 30

(12) BECAUSE having regard to the nature of the Company's business, the financial history of the Company, the prospects of the business as known on the 7th September 1940, and the then World situation, the "balance sheet" method of valuation, which makes no allowance for goodwill, adopted by the Respondents is the appropriate method.

(13) **BECAUSE** the true conclusion to be drawn from the evidence is that the said shares would not have fetched more than Rs. 40.6188 per share if sold in the open market at the date of the death of the deceased (the 7th September 1940).

(14) **BECAUSE**, for the reasons stated therein, the Judgment of the Supreme Court was right.

FREDERICK GRANT.

E. IRVINE GOULDING.

RAYMOND WALTON.

In the Privy Council.

ON APPEAL

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BETWEEN

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and

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CRAIB MACKIE.

Case for the Respondents.

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