*Privy Council Appeal No.* 27 *of* 1958

**George N. Houry, Q.C.** - - - - - - - - *Appellant*

*v.*

**The Commissioner of Income Tax** - - - - - *Respondent*

FROM

## THE COURT OF APPEAL FOR EASTERN AFRICA

## JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 12TH NOVEMBER, 1959

*Present at the Hearing:*

VISCOUNT SIMONDS
LORD RADCLIFFE
LORD KEITH OF AVONHOLM

[*Delivered by* LORD RADCLIFFE]

The East African Income Tax (Management) Act, 1952, which it will be convenient to refer to as the Income Tax Act, contains two sections, S. 22 and S. 24, the effect of each of which is to attribute to a person income as paid to or received by him despite the fact that no such income has actually been paid or received. Each section has its analogue in the taxing code of the United Kingdom; their purpose is by a fiction to place in the hands of a taxpayer income which, though not his in the eyes of the law, is thought to be fairly attributable to him in the measurement of his taxable capacity. By the first, S. 22, the undistributed portion of the total income of certain companies, subject to a limit of 60 per cent. of such income, is deemed to have been distributed as dividend among the shareholders of the company, if the Commissioner of Income Tax makes an order to that effect, and the proportionate share of each shareholder is then to be included in his own total income. The second, S. 24, requires that any income which by virtue of a settlement is paid to or for the benefit of a child of the maker of that settlement during the infancy of the child shall be treated as the income of the settlor for the purposes of the Act and not as the income of any other person.

The short question raised by this appeal is whether the dividend which is deemed to have been paid under S. 22, when an order affecting the company comes into operation, is to be reckoned as a payment of income to or for the benefit of a child shareholder when the computation of a settlor's income is made for the purposes of S. 24. Another way of putting the question is to ask whether the notional payment that is effected under S. 22 amounts to a "payment" for all the purposes of the different sections of the Act, or at least of S. 24; or whether the fiction that it sets up is for the purposes of S. 22 alone and is confined in its operation to that S. 22 and the resulting assessment.

The facts upon which this question arises are simple. The company involved is called Coastal Freights & Co. Ltd. and is registered in Tanganyika. Its share capital is Shs.500,000, divided into 500 shares of Shs.1,000 each. The appellant holds 251 of these, his wife 49 and his two infant sons 100 each. Their holdings were transferred into their names by their father, the transfer constituting a "settlement" within the meaning of S. 24 of the Income Tax Act.

On the 17th November, 1954, the respondent made an order under S. 22 that 60 per cent. of the company's income for the periods ending the 31st December, 1950, and 31st December, 1951 respectively, should

be deemed to have been distributed among its shareholders, with the result that each child was deemed to have received Shs.44,162 in respect of the first year and Shs.33,568 in respect of the second.

Assessments were then made upon the appellant on the basis that under S. 24 these sums were to be treated as part of his income. The actual assessments involved were in the sum of Shs.104,304 for the year of income 1951 and Shs.72,900 for the year of income 1952, the difference being due to the sums attributable to him in respect of his own shareholding. No challenge is made to the assessments so far as they relate to these last sums.

The appellant appealed against the assessments so far as they related to the "dividends" on the children's shares. The course that the case has taken hitherto is that the respondent refused to amend the assessments: on appeal, the High Court of Tanganyika (Lowe, J.) confirmed them; and on 2nd April, 1958, the Court of Appeal for Eastern Africa (O'Connor, P., Forbes, J. A., and Macduff, J.) dismissed his appeal from the High Court. It is now for their Lordships to express their opinion upon the issue involved.

The words of S. 24 (1) that are to be construed run as follows:— "Where, by virtue or in consequence of any settlement to which this section applies and during the life of the settlor, any income is paid to or for the benefit of a child of the settlor in any year of income, the income shall be treated for all the purposes of this Act as the income of the settlor for that year and not as the income of any other person".

With regard to the ambit of these words it is, of course, apparent that in the present case no income has in fact been paid to or for the benefit of a child. No payment has been made at all. All that has happened is that a fictitious payment of dividend has been brought about by the operation of the order made under S. 22. Unless therefore the effect of such an order is to impose upon the meaning of the word "paid" in S. 24 an interpretation which includes sums deemed to have been paid by virtue and for the purposes of another section of the Act, these notional dividends attributed to the children are not within the charge of S. 24 and cannot be treated as the income of the father.

In the High Court a solution of the difficulty was found by reference to the special provisions of S. 24 (2) (*a*). This construction of the subsection was not adopted by the Court of Appeal and was not relied upon in argument before the Board. Their Lordships do not therefore refer to it further except to say that they would not find it maintainable. The point of view that commended itself to the Court of Appeal, on the other hand, was in substance that since the order under S. 22 had the effect of bringing about a notional payment of dividend and attribution of income to the children for the purposes of the Act, that statutory fiction of a payment having taken place ought to be carried through and applied in any other part or section of the Act in which a payment to the children was referred to. The argument is stated cogently and persuasively in the judgment of Forbes, J. A., who delivered the opinion of the Court. In effect, it treats the provision in S. 22 which requires the assumption of a fictitious payment in order to impose the charge created by that section as if it set up an interpretation of the general meaning of the word "paid" throughout the body of the Act.

Their Lordships do not think that S. 22 can be treated in this way or that the Income Tax Act is so constructed as to allow the assumptions of S. 22 to be imported into the operation of S. 24. The two sections are independent charging provisions and the charges which they impose are mutually exclusive. If the relevant words of S. 22 (1) are set out it will be seen that they run as follows:—"the undistributed portion of sixty per cent. of such total income of the company for that period shall be deemed to have been distributed amongst the shareholders . . . and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purposes of this Act". It is not merely that there is to be a notional payment of dividend: it is also that each shareholder's share of the dividend is to be included in his total income for the purposes of the

Act. The dividend then must go into the total income of the child who owns the shares and for the purpose of taxation it is to be treated as his income. Such an enactment would be blankly inconsistent with the enactment contained in S. 24 that whatever is paid to or for the benefit of a child is to be treated for all the purposes of the Act as the income of the father and not as the income of any other person if "paid" in this section were to include what is deemed to be paid by the earlier section. It appears to their Lordships to be the unavoidable conclusion that in construing S. 24 the income "paid" within the meaning of that section and as such attributed to the father cannot include income deemed to be distributed by virtue of S. 22 and as such attributed to the child.

It is natural to look to the other provisions of the respective sections to see if they throw any light upon the meaning to be given to the word "paid" in S. 24. So far as they go, they favour a construction of that word that does not extend it beyond actual payments that have reached the child or its trustee. Subsection (4) of S. 24, for instance, gives a settlor who has paid tax on the income attributed to him a right to recover the amount of the tax from the "trustee or other person to whom the income is payable" under the settlement. There is nothing surprising in this right of recoupment so long as it does not extend beyond cases where an actual payment of income has been made. It would be a very surprising thing on the other hand to find provision for this right to be asserted against a trustee or beneficiary who had never had any money at all in his hands and, for all that appears, might never at any time receive any distribution on his shares except the fictitional one introduced by S. 22. Again, S. 22 (4), which gives a shareholder the right to require the company to pay his tax to the Commissioner, where no actual distribution has taken place, operates only when "the proportionate share of any shareholder . . . in the undistributed profits . . . has been included in his total income". This is not just a piece of machinery: some such right as this is an important part of any scheme which taxes persons in respect of income which they have never had and may have no power to obtain. Yet it is impossible to find any acceptable explanation of the manner in which this subsection could be made to work if the respondent's argument is right, since (*a*) the proportionate share would not have been included in the total income of the child, but of the father, and (*b*) the child is, but the father is not, the shareholder in the company.

It is fair to recognise that the appellant's argument is itself capable of producing anomalies in the relation between the charges imposed by the two sections. But the effect of them is only to drive home the point which has appeared from the considerations adduced above, that the two sections cannot be read as part of a co-ordinated scheme in which the provisions of one reflect upon and adopt the provisions of the other. They do not in fact harmonise as they stand: if they are to be harmonised it must be by new enactment of the Legislature in which the various complications of their inter-relation can be foreseen and specifically provided for.

For these reasons their Lordships will humbly advise Her Majesty that the appeal should be allowed; that the Order of the Court of Appeal for Eastern Africa dated 2nd April, 1958, and the Order of the High Court of Tanganyika dated 12th November, 1956, be set aside and that the respondent be ordered to pay the appellant's costs of those two hearings; and that the Assessments T, 1234 and 3718 which are under appeal should be remitted to the respondent with directions to amend them in accordance with their Lordships' opinion here expressed. The respondent must pay the costs of the appellant of this appeal.

(39931) Wt. 8078—37 100 12/59 D.L.

**In the Privy Council**

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GEORGE N. HOURY, Q.C.

*v.*

THE COMMISSIONER OF INCOME TAX

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DELIVERED BY LORD RADCLIFFE

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