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IN THE PRIVY COUNCIL No. 42 of 1958

O N A P P E A L

FROM THE COURT OF APPEAL FOR EASTERN AFRICA AT NAIROBI

B E T W E E N

RALLI ESTATES LIMITED ... ... Appellants

- and -

THE COMMISSIONER OF INCOME TAX ... Respondent

C A S E FOR THE RESPONDENT

Record

1. This is an appeal from a judgment of the Court of Appeal for Eastern Africa at Nairobi (O'Connor P. Briggs VP and Forbes J.A.) dated the 22nd day of May 1958 upon an appeal by Ralli Estates Limited from a Judgment and Decree of the High Court of Tanganyika at Dar es Salaam (Mr. Justice Crawshaw) dismissing two appeals against two Notices of Refusal dated the 15th day of July 1955 issued by the Respondent. By the Judgment of the Court of Appeal for Eastern Africa the Judgment of the High Court, dismissing the appeals against the said Notices of Refusal, was affirmed.

[Margin: 10; pp.138-180; p.47; p.76; pp. 1 & 26; 20]

2. The matter arises upon two assessments to Income Tax made upon the Appellant, under the East African Income Tax (Management) Act 1952 by the Respondent, one such assessment relating to the Year of Income 1951 and the other such assessment relating to the Year of Income 1952. The point in question, which is the same in the case of each assessment, relates to the disallowance as a deduction in computing the income of the Appellant of the sums of £94,326 (in respect of the Year of Income 1951) and £80,274 (in respect of the Year of Income 1952). These two sums were paid by the Appellant to the Government of Tanganyika, in the circumstances hereinafter summarised. The contention of the Appellants is that the sums in question are deductible for income tax purposes as being payments made on income account, whereas the contention of the Respondents is that the said sums are capital payments and are consequently not

[Margin: No.8 of 1952; 30; 40]

Record

deductible for the purposes of income tax.

3. The facts of the Case are set out in detail in the Record and are summarised as follows:-

(i) The Appellant Company was incorporated in Tanganyika on the 21st day of December 1950 as a subsidiary of Ralli Brothers Limited

(ii) Negotiations took place between Ralli Brothers Limited and the Government of Tanganyika in the year 1950 concerning the disposal of certain Sisal estates which had vested in the Government as enemy property during the late war. Ultimately the Appellant purchased from the Government of Tanganyika an interest referred to and termed a Right of Occupancy in certain of the said sisal estates including the Lanconi and Mjesani Sisal Estates together with an additional 6000 hectares of undeveloped land adjacent thereto (which are hereinafter together referred to as "the Ralli Estates") with effect from the 1st day of January 1951 under the terms of an offer dated the 20th day of December 1950 of a Right of Occupancy set out as Document 7 of Appendix A of the Appellant's Statement of Facts dated the 11th day of October 1955. As appears the offer was accepted by the Appellant on the 31st day of December 1950.

pp.17-22

(iii) The Purchase price payable by the Appellant in respect of the said Right of Occupancy (which extends over 99 years) of the Ralli Estates was the sum of £491,600. (Of this sum £449,646 was related to immovable property and £41,954 to movable property, but this division was made for the purpose of assessing stamp duty and is not material hereto).

In addition thereto an annual rent is also payable by the Appellant, but no question relating thereto arises in this appeal.

(iv) The said purchase price was under the agreement made between the Appellant and the Government of Tanganyika divided into two parts. One such part, namely £317,000 was payable in three instalments. These instalments, which consisted of 10 per cent, 50 per cent and 40 per cent of £317,000 respectively were duly paid, the last

Record

such instalment being paid by the Appellant on the 24th day of January 1951. No question in this Appeal arises in connection with this part of the purchase price since the Appellant has not claimed to deduct the same in computing its profits for income tax purposes.

(v) The second part of the purchase price, namely £174,600 was under the said agreement, payable by monthly instalments, the first such instalment
10 becoming due on the 15th February 1951. The said amount of £174,600 was in fact paid by such monthly instalments as to £94,326 in the year 1951 and as to £80,274 in the year 1952. These are the sums to which this appeal relates.

(vi) The said agreement provided that the monthly instalments were to be assessed by reference to the tonnage and price of the Sisal fibre produced on the Ralli Estate and exported during the month preceding the month in which the particular
20 instalment became due; and that the said monthly instalments should be paid until such time as either the balance of the purchase monies (that is to say the second part of the purchase price namely £174,600) was paid or until the total fibre tonnage of 19.397 tons should have been cut and accounted for whichever should first occur. This formula, by limiting the total instalments payable to a specified tonnage of fibre, provided a method by which the purchase price would be
30 reduced, in the event of an appreciable fall in the price of sisal before the total purchase monies had been paid.

4. The relevant provision of the East African Income Tax (Management) Act 1952 No. 8 of 1952, is Section 14(1) thereof which is as follows:-

14(1) "for the purpose of ascertaining the total income of any person there shall be deducted all outgoings and expenses wholly and exclusively incurred during the year of income by such person
40 in the production of the income including - "

5. The specific question of law raised in the Appeal shortly stated is whether the amounts payable by monthly instalments are deductible under Section 14(1) of the East African Income Tax (Management) Act 1952.

Record

6. The Appellant objected to the assessment made by the Respondent for the Year of Income 1951 and also to the assessment made by the Respondent for the Year of Income 1952 in so far as the Respondent refused to allow the said sums of £94,326 and £80,274 as deductions as aforesaid.

p.26
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By Notices of Refusal dated 15th July 1955, the Respondent gave notice that he was not prepared to amend the assessments. The Appellant appealed to the High Court against the said Notices of Refusal by the memoranda of Appeal dated 11th October 1955.

p.27
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7. The grounds of the Appeal to the High Court of Tanganyika were that:-

(a) The said payments constituted outgoings and expenses wholly and exclusively incurred by the Appellant in the production of the Appellant's income for the year of income 1952 and should accordingly be allowed as a deduction for the purpose of ascertaining the Appellant's total income under Section 14 of the East African Income Tax (Management) Act 1952;

(b) In the alternative the said payments were paid as royalties in accordance with the particulars of certain sisal estates advertised on behalf of the Government and should accordingly as a revenue payment be allowed as a deduction for income as aforesaid;

(c) In the alternative the said payments represented part of the cost to the Appellant of Stock-in-Trade and should accordingly be allowed as a deduction from income as aforesaid.

Two other grounds of appeal were not pursued.

p.47

8. The High Court of Tanganyika (Crawshaw J.) dismissed the appeals on the 30th day of March 1957 and held that the monthly instalments were instalments of the capital sum of £174,600 and were therefore not deductible. The order to that effect was made on 18th April 1957.

p.47

Crawshaw J. in the course of his Judgment

Record

said that, as Counsel for both parties agreed, the principles which in England have been held to govern the determination whether a payment is capital or revenue are in the main equally applicable in Tanganyika. After discussing the question of whether the Court was precluded from admitting evidence extrinsic to the Agreement contained in the letter of the 20th December 1950, Crawshaw J. stated that in considering whether a payment is capital or income the true nature of the transaction must be determined in all the circumstances. p.58 p.59 p.60

The learned judge then dealt with four reasons given by the Appellant in submitting that the monthly payments aggregating £174,600 are properly deductible under Section 14. The primary reasons given were (1) that they were "true royalties"; and (2), that they were made for the "right to exploit sisal potential". He decided that the transaction was intended to be one between a vendor and a purchaser; and what was offered for disposal was the estates and everything to go with them including their value as leaf producers. What was to be paid was a rent in respect of the undeveloped value of the land and a lump sum or sums in respect of the "unexhausted improvements". This phrase he said included everything not covered by the rent. He then turned to the third argument advanced by the Appellant, namely that even if the payments were to be regarded as part of the purchase price, they were still "payments of an income nature". After reviewing certain authorities Crawshaw J. held that the "premium" of £317,000 and the "royalty" of £174,600 could not be differentiated except as a method of payment, both were part of the same capital lump sum. The learned judge rejected the argument that the payments were expenditure on revenue account in accordance with ordinary accountancy principles, on the grounds that the terms of the contract were of cardinal importance and their interpretation was a question of law not of accountancy. p.62 p.64 p.65 p.65 p.66 p.69 p.71 p.72

Crawshaw J. next considered whether what was acquired was stock-in-trade, and concluded that it was not, but that what was acquired was inter alia an interest in the land. p.72 p.73

Crawshaw J. concluded his Judgment by saying p.75

Record

that to his mind the monthly payments were instalments (though variable and uncertain) of the capital sum of £174,600 and were not therefore deductible for purposes of income tax, and he accordingly dismissed the appeal.

p.77

9. The Appellant appealed to Court of Appeal for Eastern Africa against the decision of the High Court on the grounds that:-

(1) For the purpose of ascertaining the total income of the Appellants for the years in question the payments totalling £174,000 (sic) were deductible as being outgoings and expenses wholly and exclusively incurred by the Appellant in the production of the Appellant's income.

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(2) The learned Judge erred in failing to hold that the payments were allowable as a deduction under the provisions of Section 14 of the East African Income Tax (Management) Act 1952 and in particular:

(a) the learned Judge erred in failing to hold that the said payments were truly in the nature of royalties and paid by reference to quantum of user.

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(b) in the alternative to the above the learned Judge erred in failing to hold that the money was paid for the right to exploit sisal potential.

(c) in the alternative to the above the learned Judge erred in failing to hold that in any event the said payments were deductible as being essentially of a revenue nature.

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(d) in the alternative to the above the learned Judge erred in failing to hold that the said payments were deductible in ascertaining total income in accordance with ordinary commercial principles and in accordance with the ordinary principles of commercial accountancy.

(e) in the alternative to the above the learned Judge erred in failing to hold that the said payments represented cost to the Appellants of Stock-in-Trade of their business.

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p.137-179

10. On the 22nd day of May 1958 the Court of

Record

Appeal dismissed the Appeal, and held that the learned Judge was right in his decision.

11. The first judgment was given by O'Connor P. who said that the provisions of the English Income Tax Acts and of the East African Income Tax (Management) Act are sufficiently similar to enable guidance to be obtained from the English authorities as to the principles to be observed in deciding whether a particular payment is of the nature of an income or of a capital payment. O'Connor P. said that in his Judgment if it was for the Appellant to displace the view of Crawshaw as being manifestly wrong then in his Judgment the Appellant had failed to discharge that onus, but in any case he had reached the same conclusion as Crawshaw J. After reviewing the authorities he stated that he must consider the form and the substance of the transaction and he had come to the conclusion that the £174,000 (sic) was paid as part of the purchase price of the 99 years' right of occupancy of the two sisal estates and the unexhausted improvements thereon and machinery etc. and not merely for the right to exploit the "sisal potential". He said that at least for the purposes of the present case the right of occupancy was equivalent to a lease, and that the grant of this right conferred an estate or interest in land. The Appellant was buying far more than a mere right of user and the payments in question were part of the purchase price. Accordingly he held that the expenditure was incurred in bring into existence an asset for the enduring benefit of the company's trade, within Lord Cave's test in <u>British Insulated & Helsby Cables Ltd. v. Atherton</u> (1926) A.C. 205 and 10 Tax Cas. 158. He then posed the question - did the Government of Tanganyika "cause the principal sum to disappear and an annuity take its place?" or was the £174,600 part of the principal sum payable for the estates which was being spread over a time? He answered this question by saying that in his opinion it was the latter. He said that the fact that payments might depend upon and vary with the profits of a business was not decisive as to whether they were capital or income payments and consequently the fact that the £174,600 might have varied did not matter. He held that the transaction was a sale of property for a fixed sum part of which was payable by instalments which might fluctuate but were not periodical payments for a mere right of user. The learned

p.149 p.151 p.152 p.154 p.161 p.165 p.165 p.166 p.166 p.167 p.167 p.173 p.173

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Record

p.175
p.176
p.176
p.177
p.178
p.179

President further held that the £174,600 did not represent the cost of stock-in-trade, but was part of the purchase price of the estates which were a capital asset. He said he would dismiss the appeal. Briggs V.P. said that he had no doubt that the whole contract was to be found in Land Officer's letter to the Appellant dated 20th December 1950 and that the sum of £174,600 was nothing more or less than a part of the purchase price as the contract stated. He rejected the argument that the rights obtained under a right of occupancy were only rights of user, it was in the most obvious sense a sale of a capital asset and the payments making up the sum of £174,600 were instalments of a variable purchase price. The argument for the Appellants that the £174,600 must be treated as a sum paid for the right to exploit "sisal potential" and that, since it was dependent on the quantum and value of production, it had all the characteristics of a true revenue royalty was, he said, fallacious in that the purchaser of agricultural land does not separately acquire the land and the rights to make a profit by using it. He, as did Forbes J.A., agreed that the appeal should be dismissed. An order of the Court of Appeal was made to that effect the same day.

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12. The Appellant applied to the Court of Appeal for leave to appeal to Her Majesty in Council and in due course an Order granting conditional leave so to appeal was on the 27th day of August 1958 made by the Court upon the terms set out therein.

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13. An order granting Final Leave to Appeal to Her Majesty in Council was made on the 2nd December 1958.

14. The Respondent humbly submits that the decision of the Court of Appeal is right and should be affirmed and that this Appeal should be dismissed with costs for the following amongst other

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1. Because the said payments were instalments of the purchase price of a capital asset and were therefore payments of a capital nature.

2. Because the said payments being of capital are not deductible for the purpose of ascertaining

total income under Section 14 of the East African Income Tax (Management) Act 1952.

3. Because the said payments being instalments of purchase price were not truly in the nature of royalties.

4. Because the said payments being instalments of the purchase price of an interest in land were not payments for the user of that land since the relevant interest in it (in the form of the right to occupy) became the property of the Appellants.

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5. Because the said payments were not essentially of a revenue nature, but of a capital nature.

6. Because the said payments were not deductible in ascertaining total income in accordance with ordinary commercial principles or in accordance with ordinary principels of commercial accounting, since they were on capital account.

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7. Because the said payments were not the purchase price of trading stock but of capital assets consisting of an interest in land and the machinery and other property thereon.

8. For the reasons given in the Judgment of the High Court.

9. For the reasons given in the Judgment of the Court of Appeal.

F. N. BUCHER

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PHILIP SHELBOURNE

No. 42 of 1958

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B E T W E E N:

RALLI ESTATES LIMITED Appellant

- and -

THE COMMISSIONER OF INCOME TAX ... ... Respondent

C A S E FOR THE RESPONDENT

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