[IN THE PRIVY COUNCIL]

1957 *Present:* Lord Tucker, Lord Cohen, Lord Somervell of Harrow, Lord Denning and Mr. L. M. D. de Silva

C. A. SPELDEWINDE (Commissioner of Income Tax), Appellant, *and* EMIL SAVUNDARANAYAGAM, Respondent

PRIVY COUNCIL APPEAL NO. 16 OF 1956

S. C. 323—In the Matter of a Case stated for the opinion of the Supreme Court under Section 74 of the Income Tax Ordinance

Income tax—Money paid under a mistake of fact—Liability to be assessed as profit of a trade—Artificial or fictitious transactions—Income Tax Ordinance (Cap. 188), ss. 6, 52 (2).

Money paid under a mistake of fact (e.g., on the assumption that certain forged documents of title to goods are genuine) to the credit of a person in his trading account is liable to be assessed to income tax as his profit from a trade, unless the assessee shows that the money has been or will be extinguished or diminished by a claim made by the person who is entitled to receive it. Money paid under a mistake of fact cannot be said to be the "property" of, or to "belong" to, the payer while it is still in the hands of the payee, although the payee is liable to pay the sum to the payer.

It is open to an Assessor to hold, if the facts warrant it, that a company or a partnership should be considered, for income tax purposes, as artificial or fictitious and falling within the operation of section 52 (2) of the Income Tax Ordinance although, as far as third parties are concerned, there is a legal basis for such company or partnership.

APPEAL from a judgment of the Supreme Court reported in *56 N. L. R. 457.*

John Senter, Q.C., with *Reginald Hills* and *R. K. Handoo*, for the Appellant.

R. Heyworth Talbot, Q.C., with *S. Nadesan, Q.C.*, *H. H. Munroe* and *Sirimevan Amerasinghe*, for the Respondent.

Cur. adv. vult.

June 24, 1957. [*Delivered by* LORD SOMERVELL OF HARROW]—

This is an appeal from a judgment of the Supreme Court of Ceylon on a Case Stated under the Income Tax Ordinance by the Board of Review. The respondent had applied for the case in respect of a determination of the Board dismissing his appeal against an assessment to income tax by the Commissioner. The assessment was confirmed subject to a reduction in amount which is not in dispute in the appeal.

2——J.N B 69096-1,593 (9/57)

The decision of the Board of Review is final subject to questions of law (section 74). The Supreme Court reduced the assessment by the sums which are in issue in this appeal, and the Commissioner of Income Tax appeals.

The question is whether certain sums received by the respondent are profits of a trade. Under the Income Tax Ordinance the tax is imposed on profits or income. Those words mean *inter alia* the profits from any trade for however short a period carried on or exercised (section 6). Trade includes every trade and manufacture, and every adventure and concern in the nature of trade (section 2). Section 52 (2) is as follows :

> Where an Assessor is of opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the persons concerned shall be assessable accordingly.

In October, 1949, the respondent formed a private company called the Transworld Enterprises Ltd. (hereinafter called T. W. E.) with an issued capital of Rs. 100 of which he and his wife held 6/10ths. In May, 1950, the respondent formed a company called Eastern Traders Ltd. (hereinafter called E. T.) with a capital of Rs. 1,000. T. W. E. controlled 93 per cent. of the shares.

The Commissioner said that it was not possible to accept as true anything the respondent said or even to accept at its face value what appears in most of the documents produced.

In October, 1950, letters passed between T. W. E. and one Renfro as representative of the Hwa Shih Co., Tientsin. The Chinese company were to buy 45,000 drums of lubricants as specified in a letter of 23rd October at a price c.i.f. $1,230,000. A credit was to be opened in Ceylon, India, or Switzerland in favour of an entity described by T. W. E. as " our subsidiary firm Messrs. Eastern Enterprises Co. " A letter of 23rd October from the Chinese Company's representative in Colombo, presumably Mr. Renfro, though his signature was illegible, contained the following paragraph :—

> We suggest that you approach in a very discreet manner one of the undernoted organizations whom we have reasons to believe will not be averse to helping you obtain supplies for shipment to China.
>
> Societe Mediterrannienne de Produits Petroliers.
> Marseilles Petrole France, Paris.
> Association of Independent Oil Cos., Teheran.
> Anglo-Iranian Oil Co., London.

The Eastern Enterprises Co. (hereinafter called E. E.) was registered by the respondent as starting business on 27th October the partners being E. T. and T. W. E.

On 27th October E. T. and T. W. E. as partners in E. E. granted the respondent a Power of Attorney in very wide terms to act in the conduct and management of all their affairs in Europe and the U.S.A.

Arrangements were made by the Chinese Company or their representative for the opening of the credit by the Union Bank of Switzerland at Zurich.

On the 28th November, 1950, the respondent left for Europe. He selected the first company on the list, hereinafter called S. M. P. P. and wrote to them from London on 30th November. Arrangements were made with a M. Duval one of the directors of the S. M. P. P. for that company to supply the lubricants. The credit opened by the Union Bank was in a usual form, the Bank requiring a sight draft on the Chinese company, invoices, bills of lading, Lloyds survey certificates confirming loading, analysis certificates from an independent laboratory and insurance policies.

The S. M. P. P. handed over the required documents to the respondent. The respondent presented these documents to the Bank on the 13th January and the Bank after four days paid $1,230,000 to the respondent as the attorney of E.E. The documents were subsequently found to be forgeries. Paragraphs 11 and 12 of the Case Stated are as follows :—

" 11. Out of this sum of 1,230,000 dollars the appellant-assessee as the attorney of the Eastern Enterprises Co. paid Duval 825,552.50 dollars. Further the appellant-assessee as attorney of the Eastern Enterprises Co. drew out the sum of 235,000 dollars in cash at the Bank's counter and paid it to himself in his personal capacity as commission earned by him for his part in this transaction. The appellant-assessee also as attorney transferred a sum of 169,447.50 dollars (equivalent to Rs. 804,785) by telegraphic transfer to the credit of the T. W. E. Ltd. at the Bank of Ceylon, Colombo. This was followed up by a cable by the appellant-assessee to Cyril Gardiner as to how the money sent by telegraphic transfer to T. W. E. Ltd. was to be distributed.

12. At the time the appellant-assessee received payment from the Bank of the said amounts totalling 1,230,000 dollars, the appellant believed *bona fide* that the Bank was making payment on genuine documents and he was not aware of the fraud which had been perpetrated by Duval in connection with the documents presented to the Bank till about the end of March, 1951, or beginning of April".

Out of the proceeds in rupees of the $169,447.50 remitted to T. W. E., a dividend of Rs. 30,000 per share of Rs. 10 was declared. The respondent and his wife received Rs. 180,000 on their shareholding. The respondent also received Rs. 5,000 described as Directors' fees. The remainder of the proceeds was paid away to a company and individuals. The Board of Review has treated these latter payments as disbursements on which the respondent is not liable to tax. The appellant accepts this position and it is unnecessary therefore to set them out.

The assessment as confirmed by the Board was as follows :—

1. The equivalent of the $235,000 received by the appellant (the present respondent) at the counter of the Swiss Bank—Rs. 1,110,264.
2. The sum paid to the appellant and his wife as dividend in terms of the Resolution of T. W. E.—Rs. 180,000.

3. Directors' fees—Rs. 5,000.

4. Other income shown in the appellant's return—Rs. 28,624.

The respondent does not dispute item (4).

The respondent was back in Colombo on 22nd January, 1951, carrying with him approximately $235,000 in U. S. A. currency notes. He was paid the equivalent in Ceylon currency by the Controller of Exchange. He dealt with the money as his personal assets.

The respondent then dissolved the partnership and took steps to wind up T. W. E. and E. T.

The "Saga" on which according to the documents the lubricants had been shipped, not having arrived by the beginning of March the Chinese company asked the Swedish East Asia Company, the owners according to the documents, for information. That company stated that they had no such ship.

There were letters from the Chinese company and the Bank to E.E. They both claimed the money. If the Bank were entitled to debit the Chinese company the Bank would have suffered no loss. If the Bank were not entitled to debit the company, the company might have a claim for breach of the contract of sale but not for the amount of the credit money.

The respondent as attorney of E. E. denied liability and put the responsibility on the Bank. Subsequently E. E. informed the Chinese company without prejudice to their rights that they would be prepared to compromise at a lower figure after the claim made by the Income Tax Department was settled.

The respondent conducted this correspondence in the name of E. E. although the partnership had been dissolved.

No sum has been paid to either the Bank or the Chinese Company and the Commissioner and the Board of Review found as a fact that the money will not be repaid.

The Board of Review treated the $235,000 as money which the respondent had lawfully earned as commission. This must have been on the basis that there was a contract of agency under which commission was earned when the respondent obtained the documents from the S. M. P. P. whether those documents were or were not genuine. If this view were right, it would provide an answer to the respondent's contention in law which will be stated in a moment. There is of course no evidence of any contract of agency except the respondent's statements which are of no evidential value.

The respondent was in control of the whole matter and dealt with the money as his own. In considering the other items and the application of section 52 (2) of the Income Tax Ordinance the Board of Review after considering the facts held "that as far as the outside world is concerned and as far as third parties are concerned there was a legal basis for the companies and the partnership but so far as the Income

Tax Ordinance is concerned they should be considered as fictitious and artificial to come within the operation of section 52 (2) of the Ordinance ".

The respondent did not dispute this and so far as the $235,000 is concerned his argument is easier to apply if he is treated for income tax purposes as if he were a principal receiving in his own right the balance of the credit moneys.

The respondent submitted and submits that the payment by the Bank having been made under a mistake of fact the money paid to the respondent still " belonged " to the Bank or to the Chinese Company. It could not therefore be submitted be treated as a credit item in his trading account. In *Kelly v. Solari* [1] Parke B. said, " I think where money is paid to another under the influence of a mistake, that is, upon the supposition that a specific fact is true, which would entitle the other to the money, but which fact is untrue, and the money would not have been paid if it had been known to the payer that the fact was untrue, an action will lie to recover it back, and it is against conscience to retain it, though a demand may be necessary in those cases in which the party receiving may have been ignorant of the mistake. "

The Supreme Court accepted the submission and referred to Lord Sumner's opinion in *R. E. Jones v. Waring & Gillow Limited* [2]. Reference was also made to Lord Wright's statement in *Norwich Union Fire Insurance Society Limited v. Wm. H. Price Limited* [3]. " The mistake, being of the character that it was, prevented there being that intention which the common law regards as essential to the making of an agreement or the transfer of money or property. " The words and phrases relied on as to " property " in money not passing and as to money paid still " belonging " to the payer may well have come down from the time when under the old action of debt the defendant was regarded as having in his possession something belonging to the plaintiff which had to be " restored " (Holdsworth History of English Law, Vol. II, 366, Vol. III, 420). In form it was similar to the action for the recovery of a chattel. Later the action of *indebitatus assumpsit,* based on a promise express or implied, was extended to cover cases such as money paid under a mistake of fact (*United Australia Limited v. Barclays Bank Limited* [4]). At the present day when it is said that the " property " in money has not passed what is meant is that the payee is liable to pay to the payer the same amount which he has received. The phrase has not the significance which the Supreme Court gave to it.

The respondent before the Board put the argument in another way. He submitted that in a purchase and sale transaction no profit arises until the seller becomes entitled to receive the purchase price. In the present case therefore there was not even a conditional or *prima facie* credit item when the money was paid. If this argument were right, it would seem to follow that in every case where there is a possibility of an adverse claim no credit item can be entered until the facts have been

[1] *9 M. & W. 54.*
[2] *[1926] A. C. 670, 696.*
[3] *[1934] A. C. 455 at p. 462.*
[4] *[1941] A. C. 1, pp. 26, 27.*

ascertained. It would also seem to follow that there is no profit even if no claim is or ever will be made if on the facts the seller was not entitled to the price.

No authority was cited for this proposition.

Their Lordships are of opinion that the argument, which commended itself to the Supreme Court is the wrong approach to the present claim.

The difference between the amount paid by the Bank and the amount paid to S. M. P. P. was on the face of it, subject to expenses, the profit of the transaction. It was when received so regarded and if books were kept it would so appear in them. There are of course numerous cases in which after the purchase price has been paid there is a claim by the buyer. It may be a claim to reject the goods and recover the purchase price, it may be a claim for damages, the goods being retained. The seller may dispute the claim, successfully. The buyer though having a claim may refrain from pressing it to avoid expense and preserve friendly relations. From the aspect of income tax the question is whether money has had to be paid out in respect of the transaction. If it has been it will normally come in on the debit side of the tax account.

If a claim is plainly going to be made, which may equal or exceed the amount of the purchase price the taxpayer will have a strong case for treating the "receipt" as conditional only until the final profit of the transaction is settled. This would have special force if the trade was being discontinued and no adjustment was later possible.

In their Lordships' opinion the fact that the "claim" is under English procedure for money had and received makes no difference. The taxpayer has still to show that the payment he has received as the purchase price has been or will be diminished or extinguished. If a claim having been quantified and admitted the Revenue authorities are satisfied that it will be paid it could, no doubt, be treated as an ordinary book debt.

In the present case therefore the respondent in order to succeed must show that the sums on which the assessment is based have been or will be extinguished or diminished. He does not seek to show that they have been extinguished or diminished. On the question as to whether they will be, it may be sufficient to refer to the finding of fact. It is worth noting the inconsistency of the respondent's case. If as he maintains to the Revenue the money is not his money, why has he not repaid it or any part of it to the Bank or the Chinese company?, or if he was doubtful as to which was entitled to it, into a joint account?

The Inspector of Taxes placed great reliance on *Southern Railway of Peru Ltd. v. Owen*[1]. That case dealt with deductions which could or might be based on accountancy apportionments of future liabilities. It was said by Lord Radcliffe, Earl Jowitt concurring, that no sum should be so deductible unless it was an essential charge against the receipts of the year. The problem there being considered seems to their Lordships quite different from the problems raised by actual and potential claims against sellers who have obtained money under a credit and it would be wrong to treat the language there used as applicable.

[1] [1956] 2 *A. E. R.* 728.

The respondent relied on *Morley v. Tattersall*[1]. That case dealt with purchase monies received by auctioneers for vendors which had not been claimed by the vendors. It was held that these could not be treated as trading receipts. The basis of the judgment in that case was that these sums were not received as profits or credit items on an account of a trade.

The sum in question here was received as the purchase price of goods sold. It was a profit of a trade and the respondent has failed to satisfy the tribunal of fact that there are sums to be placed on the other side of the account which would extinguish or diminish it.

For the reasons which have have been given their Lordships will humbly advise Her Majesty that the appeal be allowed and the determination of the Board of Review confirmed. The respondent must pay the appellant's costs in the Supreme Court and of this appeal.

Appeal allowed.