1955 *Present :* **Gratiaen J. and Sansoni J.**

EMIL SAVUNDRANAYAGAM, Appellant, *and* COMMISSIONER OF INCOME TAX, Respondent

S. C. 323 and 325—In the matter of a case stated for the opinion of the Supreme Court under the provisions of Section 74 of the Income Tax Ordinance (Cap. 88)

Income tax—C.i.f. contract—Payment of purchase price—Void ab initio—Liability of the seller or his agent to be taxed in respect of the assumed profits.

When money is paid by A to B under a mutual mistake as to the substance of the whole consideration, B is not liable to pay income tax in respect of the money received by him.

In a c.i.f. contract for the sale of a large quantity of oil it was stipulated that the purchase price of the goods should be paid by the buyer's Bank to the seller's agent, S, on the presentation by S to the Bank of documents relating to the shipment of the oil. S received payment of the purchase price against certain documents but it was subsequently discovered that a person D, who had been entrusted by S with the matter of shipping the oil, had committed a very serious fraud ; no oil had in truth been shipped, and every document forwarded by D to S in proof of the purported shipment was a forgery.

Held, that as S's mandate was to secure an *actual* fulfilment of the seller's obligations and to obtain the purchase price in exchange for *genuine* documents S was not liable to pay income tax on any money received by him, as commission or dividend, out of the assumed profits derived by the seller from the contract of sale.

CASE stated for the opinion of the Supreme Court under section 74 of the Income Tax Ordinance.

H. V. Perera, Q.C., with *S. Nadesan, Q.C.*, *C. Renganathan* and *N. Nadarasa*, for the assessee (appellant in No. 323 and respondent in No. 325).

T. S. Fernando, Q.C., Acting Attorney-General, with *M. Tiruchelvam*, Deputy Solicitor-General, *V. Tennekoon* and *R. S. Wanasundera*, Crown Counsel, for the Commissioner of Income Tax (respondent in No. 323 and appellant in No. 325).

Cur. adv. vult.

March 4, 1955. GRATIAEN J.—

This appeal (No. 323) comes up by way of a case stated for the opinion of the Supreme Court under section 74 of the Income Tax Ordinance.

The assessee was a director of two private companies called Transworld Enterprises Ltd. (the "T. W. E. Company") and the Eastern Traders Ltd. (the "E. T. Company"). Between August 1950 and October 1950 he entered into negotiations in Colombo with a representative of the Hwa Shih Company (the "Chinese Company") for the supply of a large

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quantity of oil to be shipped direct to them at Tsingtao. Eventually, on 23rd October, 1950, he accepted on behalf of the T. W. E. Company an order to supply 45,000 drums of oil (at various specifications) for 1,230,000 dollars c. i. f., stipulating that the purchase price should be assured in advance by a letter of credit opened in Ceylon, India or Switzerland " in favour of our subsidiary firm, Messrs. Eastern Enterprises Company ". On the same day the representative of the Chinese Company " confirmed " the contract and on 29th November, 1950, the Chinese Company arranged for a reputable Bank in Switzerland to open an irrevocable letter of credit A 27 in favour of the Eastern Enterprises Company whereby the Bank undertook to pay the purchase price against bills drawn by the Eastern Enterprises Company " *accompanied by the following documents :* (1) commercial invoice in duplicate, (2) full set clean on board bills of lading, (3) Lloyd's survey certificate, (4) analyst's certificate of quality, (5) Insurance policy ".

Something must now be stated with regard to the Eastern Enterprises Company. The assessee had apparently arranged that, if a contract could be negotiated for the sale of lubricants to the Chinese Company, the business should be undertaken by a partnership called the Eastern Enterprises Company consisting of the T. W. E. Company and the E. T. Company. This partnership in fact came into existence on 27th October, 1950, and was registered a few days later. The correspondence makes it clear that it was the partnership which thereafter undertook the responsibilities of the seller under the c. i. f. contract and as such became entitled to receive payment of the purchase price upon the due completion of the sale.

On 28th November, 1950, the assessee, armed with a general power of attorney from the partnership, went to Europe in search of someone who was in a position to supply the oil required for shipment to China. He eventually contacted a rogue named Pierre Duval who represented that he was willing and able to ship the entire quantity from Marseilles to Tsingtao for 825,552/50 dollars. The arrangement was that Duval, having shipped the oil should send the relative documents to the assessee who would in turn present them to the Swiss Bank. Having received payment against these documents, the assessee would pay Duval his purchase price leaving a considerable margin of profit for the partnership.

Early in January 1951 Duval informed the assessee that the oil had in fact been shipped as arranged, and he furnished the assessee with the documents in proof of shipment. These documents were presented by the assessee to the Bank together with a bill of exchange drawn on the Chinese Company. On 17th January, 1951, the Bank made full payment to the assessee who in turn settled Duval's account for 804,475 dollars. The balance sum (so it was thought) represented the gross profits earned by the partnership in this fabulous venture. Out of this amount, the following sums were received by the assessee personally in Ceylon currency :—

(1) Rs. 1,110,264 " as commission earned by him for his part in the transaction " ;

(2) Rs. 180,000 as dividends paid out to him and his wife (out of the "profits" from the same transaction) by the T. W. E. Company;

(3) Rs. 5,000 as Director's fees (also paid out of the same "profits").

The assessee's appeal raises the question whether these three payments represented "income" in his hands so as to attract tax under the Ordinance. Before discussing this issue, however, it is necessary to return to the facts as found by the Board of Review.

After the payments and distributions previously referred to had been made it was discovered that Pierre Duval had committed a very serious fraud. No oil had in truth been shipped to China, and every document forwarded by him to the assessee in proof of the purported shipment was a forgery. In the result, the assessee (on behalf of the partnership) had forwarded to the Swiss Bank nothing but worthless documents and received in exchange for them the purchase price of a non-existent consignment of oil. The Board was satisfied, however, that at that time the assessee "believed *bona fide* that the Bank was making payment on genuine documents and became aware of the fraud and forgery for the first time about the end of March or the beginning of April 1951".

There was evidence before the Board to support these findings of fact, and we have therefore no option but to accept them as correct for the purpose of answering the questions of law submitted for our opinion.

The Board decided that the assessee was liable to pay tax on the three payments enumerated by me because (1) in receiving the purchase price from the Bank in terms of the letter of credit A 27 upon documents *bona fide* but erroneously believed at that time to be genuine, the partnership "had done all that they were required to do", (2) the payments made to the assessee by the partnership out of this sum by way of commission, dividends and Director's fees were similarly *bona fide* received and properly earned by him.

Mr. Perera has submitted that the legal inferences drawn by the Board upon the facts as determined by them are insupportable. His argument is that the payments of the purchase price was void *ab initio*, and that no property in any part of the assumed "purchase price" ever passed to the partnership or thereafter from the partnership either to the assessee or (in the case of the dividends) to the assessee's wife. The learned Attorney-General supported the conclusions arrived at by the Board, and argued in the alternative that, even if money became liable to be refunded by the partnership upon the discovery of Duval's fraud, it could not be followed in the hands of the assessee or his wife (they having received it innocently and for value).

I must dissociate myself at the outset from the remarkably cynical theory that the partnership had done "all that it was required to do" in order to "earn" the purchase price either under the contract of sale or under the letter of credit which guaranteed payment upon due compliance with the conditions therein stipulated. The documents which form the basis of the Board's determination make it clear that the partnership had assumed in every respect the obligations of a seller, and that the purchase price could only be "earned" upon presentation of genuine documents

relating to a genuine shipment. The passing of property in the goods to the buyers and in the purchase price to the seller were intended to take place simultaneously.

I agree with Mr. Perera that in the circumstances of this case the property in the money did not pass to the partnership. The money was paid by the Bank and received by the assessee on behalf of his partners under a common mistake about a matter which was as fundamental in character as one can conceive of in relation to a c.i.f. contract and a letter of credit undertaking to pay the purchase price under a c.i.f. contract. The payment was made under " a mistake or misapprehension as to the substance of the whole consideration, going as it were to the root of the matter ". *Kennedy v. Panama, New Zealand and Australian Royal Mail Co.* [1]. In these circumstances, "the mind of the grantor did not go with the transaction at all ; his mind went with another transaction, and he was meaning to give effect to that other transaction, depending upon facts different from those which were the true facts", per Lord Shaw in *Jones v. Waring and Gillow* [2]. As Lord Sumner pointed out in the latter case, " the passing of property is a question of intention, and just as much so in the case of a payment of money as in the case of the transfer of a chattel ".

The common mistake which the Bank and the assessee (as attorney of the partnership) shared at the time of the payment was of a kind which in the opinion expressed by Lord Atkin in *Bell v. Lever Brothers Ltd.*[3] rendered the transaction and the payment void *ab initio*, so that the Bank's consent to the transfer of the property in the money was nullified. " The mistake prevented there being an intention which the common law regards as essential to the making of an agreement *or the transfer of money* or property ". *Norwich Fire Insurance Ltd. v. Price* [4].

Both parties were content to argue the appeal before the Board of Review on the assumption that the English law applied. In my opinion this assumption was justified by the provisions of section 58 (2) of the Sale of Goods Ordinance because the payment was intended to be made as consideration under a concluded contract for the sale of goods. The effect of common mistake upon the validity of the transaction is therefore governed by the rules of the English law. But the controversy seems to be only of academic interest. Even under the Roman-Dutch law, the true position was that the common mistake fraudulently induced by Duval vitiated the payment. " The mere delivery of an article does not transfer its ownership, for this takes place only when a sale *or some other just cause* precedes delivery ". *Digest 41. 1. 31 ; Wessells on Contract in S. Africa*—vol 2, para 3636. See also *Voet 18. 1. 5* and *18. 1. 6* where a clear distinction is drawn between the kinds of " error " which would render a contract void and those which render it merely voidable.

I concede that the case for the taxing authority is not necessarily concluded by the circumstance that the money received from the Bank never passed into the ownership of the partnership. If, for instance, it had been diverted into the hands of a third party who received it in good faith and for value, the third party could thereby (under the English law)

[1] *(1867) 2 Q. B. 580.*
[2] *(1926) A. C. 670.*
[3] *(1932) A. C. 161.*
[4] *(1934) A. C. 455.*

claim that the money had now become his own property. The rules of Roman-Dutch law are very similar. *Wessells* (*supra*), paras 3712-3716. The question therefore remains whether all or any of the relevant sums subsequently received by the assessee from the partnership by way of commission, dividends and Director's fees can properly be regarded as having become his "income" for taxing purposes, although the money did not belong to the partnership itself at any time.

Let us first consider the sum of Rs. 1,110,264 appropriated by the assessee on 17th January, 1951, out of the assumed profits of the partnership. The Board held that this amount had been "lawfully earned by him as commission" and received by him at a time when he "knew" (i.e., I presume, "believed") that the partnership had "legal title to the money". I find it impossible to adopt this line of reasoning. In my opinion, the determination that the Company and assessee acted *bona fide* rules out the theory that the assessee could have been intended to "earn" his commission merely by obtaining payment for forged documents. His mandate was to secure an *actual* fulfilment of the seller's obligations under the contract of sale and to obtain the stipulated purchase price in exchange for *genuine* documents securing for the seller title in the goods and indemnifying him against risks during shipment. He originally entertained the belief that he had earned his commission, but the truth is that he had not. No doubt he received the money *bona fide*, but not in exchange for anything approximating to the services intended to be rendered by him. Accordingly, the ownership in this part of the fund never passed to him for the same reason that it had previously not passed to the partnership from the Bank.

Similarly with regard to the dividend and the Director's fees. Obviously the intention (to which he was himself privy) was to distribute profits actually earned by the partnership from this particular venture; but as no such profits were in fact earned, there was no effective transfer of money to the assessee.

The documents produced before the Board established that, after the fundamental error was discovered, the assessee (on behalf of himself and his principals) undertook to refund to the Chinese Company such part of the purchase price as was still within his control. Whether he fulfils that undertaking or not, the fact remains that the money is not (and never was) the property of himself or his principals.

In my opinion, it is unnecessary to give a detailed answer to the specific questions submitted for our opinion. I would reduce the assessment determined by the Board by deleting the sums of Rs. 1,110,264, Rs. 180,000 and Rs. 5,000 in respect of which the assessee was not assessable. He is entitled to the costs of this appeal and to a refund of the sum deposited by him under section 74 (1) of the Ordinance.

There remains the Commissioner's connected appeal (No. 325). The conclusions already arrived at by me leave no room for adopting the argument that the assessment should be increased by the addition of other items representing a further distribution of the imagined "profits"

of the partnership. Moreover, the learned Attorney-General very fairly informed us that he could not support that part of the case for the Commissioner, whose appeal must therefore be dismissed with costs.

SANSONI J.—I agree.

Appeal No. 323 allowed.

Appeal No. 325 dismissed.