IN THE COURT OF APPEAL, FIJI

[ON APPEAL FROM THE HIGH COURT]

Civil Appeal No. ABU 0080 of 2018

(High Court HBT Action No. 02 of 2017)

BETWEEN	:	**RAINBOW REEF ENTERPRISES LIMITED**
		Appellant
AND	:	**FIJI REVENUE AND CUSTOMS AUTHORITY**
		Respondent
Coram	:	**Lecamwasam JA**
	:	**Almeida-Guneratne JA**
	:	**Jameel JA**
Counsel	:	**Mr. H. Nagin with Mr. S. Fatiaki for the Appellant**
		Mr. O. Verebalavu with Mr. E Eterika for the Respondent
Date of Hearing	:	**04 February 2020**
Date of Judgment	:	**28 February 2020**

JUDGMENT

Lecamwasam JA

[1] I agree with the reasons and the conclusions reached by Jameel, JA.

Almeida Guneratne JA

[2] I agree entirely with the judgment, reasons and the orders proposed by Her Ladyship Justice Jameel.

Jameel JA

Introduction

[3] On 17 August 2016, the Respondent issued an Amended Assessment against the Appellant company (‘***the Appellant’***). The Appellant filed its Objections to the Amended Assessment. By its Objection Decision dated 16 January 2017, the Respondent dismissed the objections raised by the Appellant. The Appellant then filed an Application for Review in the Tax Tribunal which, on 19 May 2017 transferred the application to the High Court. By judgment dated 25 July 2018, the learned High Court Judge dismissed the Application for Review. This is an appeal against the said Judgement of the High Court.

[4] The essence of the matter for determination by this court is whether the discharge of the Appellant’s liabilities by its shareholders, is a *profit or gain accrued or derived* by the Appellant, within the meaning of section 11 of the Income Tax Act, (Cap.201.)

[5] The Appellant is a private limited liability company duly incorporated in Fiji, is registered with the Respondent and has a Tax Identification Number 50-11801-0-6. It was originally engaged in owning, developing and selling land. It later came to be engaged in ground upkeep and maintenance.

Chronology of Events

The Period between 2003 and 2015

[6] The Appellant’s original shareholders *(“**original shareholders**”)* were Lawrence Gale Hastings and Scilla Blackwell Hastings. The Hastings owned the entirety of the shares in the Appellant. In 2002, its Financial Statements had recorded liabilities. Mr. and Mrs. Maston, (“***the new shareholders***”) responded to a newspaper advertisement for the sale of property in Vanua Levu, as a result of which they purchased two adjacent lots of land from the Appellant company. It appears that the Mastons later wished to also purchase the shares of the Appellant. Negotiations commenced, and the predominant basis of

finalization of the purchase price of the shares, was the discharge by the original shareholders of all existing liabilities of the Appellant. This had a significant and material impact on the selling price of the shares. As agreed, the original shareholders discharged the entirety of the liabilities of the Appellant, and by Sale and Purchase Agreement dated 22 October 2002 (RHC Vol. p.63), the shares were transferred to William Maston and Kristin Thompson Maston, for a purchase price of US $408,000.00.

[7] In the meanwhile, the Appellant had been lodging its annual Income Tax returns together with its Financial Statements which included its Profit and Loss Account.

[8] In the Accounts for the Year Ended 31 December 2003, (RHC 213), the Appellant's Accountant had declared that the accounting policies adopted by the Appellant are in accordance with the Accounting Standards recommended by the Fiji Institute of Accountants, and by law. The significant accounting policies adopted by the Appellant were also set out in the yearly financial statements.

[9] In Note 3 of the Statement of Accounts for the Year Ended 31 December 2003 (the year in which the transfer of shares took place), the Accountant had stated as follows;

> "*During the year there was change in shareholding and all the company's shares were acquired by totally new shareholders. These shares were acquired on the basis that all liabilities of the company as at the date of change in shareholding were to remain with and would be the responsibility of the company's previous shareholders. This has been treated in the accounts as a forgiveness of debt owed by the company to the previous shareholders and the same credited to capital reserve,"*

[10] This Note had been continuously repeated in the Financial Statements that accompanied the respective Returns from 2002 to 2012.

The Period after 2015

[11] Several years went by, and until 2015, the Respondent did not in any manner query the said Note to the Financial Statements and the *status quo* continued. As had been done regularly in the past, the Appellant on 22 May 2015, lodged its Income Tax Returns for the Year of Assessment ended 31 December 2014, and on 28 May 2015, the Respondent issued an Original Assessment to the Appellant. (RHC Vol.1 p 46). Nothing of significance flows from this.

[12] Subsequently, by letter dated 8 June 2016 the Respondent informed the Appellant that in terms of section 37 of the Tax Administration Decree 2011, it would be conducting an integrated audit of the affairs of the Appellant, which would initially cover the "*period 2012 to 2014*."

[13] In 2016, the Appellant was audited and a '*schedule of discrepancy'* was issued on 17 June 2016 (RHC Vol.1, p.49), on the basis that the '*forgiveness of the Company's debt'* by the previous shareholders was considered income in the hands of the Appellant company.

The Amended Assessment: - Respondent's Position

[14] The position taken by the Respondent in respect of the discharge of the liabilities of the Appellant by its previous shareholders was contained in its letter dated 17 June 2016, and was *inter- alia* as follows:

> *"It is noted that company has recorded a capital reserve of $533,717.00 resulting from the change of shareholding on note 3 of the financial statement. The note further elaborates that'… all the liabilities of the company as at the date of change in the shareholding were to remain with and would be the responsibility of the company's previous shareholders. This has been treated in the accounts as a forgiveness of a debt owed by the company…'*

The forgiveness of the said company debts is considered to be an income for the company and same will be subject to income tax under Section 11 of the Income Tax Act. Consequent tax effect of this is summarized below.

Year	*Amount subject to Tax*	*Accumulated Losses as at 31/12/14*	*Chargeable Income*	*Tax Payable*	*Penalty (20%)*	*Total Payable*
2014	*533,717.00*	*(217,931.71)*	*$315 85.29*	*$63,157.06*	*$12,631.41*	*$75,788.47*

"

[15] Subsequently, on 30 June 2016, the Respondent issued to the Appellant, the impugned Notice of Amended Assessment (RHC Vol1. P. 52).

[16] In the Amended Notice of Assessment, under the heading '*Penalty* (sic) *Making False Statements for 2014"* the Respondent had charged the Appellant a sum of $12,631.41 and demanded that the money be paid by 1 August 2016. Under the heading "*Late Payment Penalty'*, the Respondent had charged the Appellant a sum of $15,731.22.

[17] The Amended Assessment stated as follows:

"

Item Type	*Item Adjusted*	*Explanation*	*Amount Adjusted in Taxable Income*
Income	*Net Profit as shown in Profit and Loss Account*	*Adjusted to Amount Assessable*	*2,968.29*
Income	*Net Profit as shown in Profit and Loss Account*	*Adjusted to Amount Assessable*	*533,717.00*

Forgiven debt is considered income and taxed under section 11 of the Income Tax Act."

[18] In its oral submissions in the court below (RHC 406), the Respondent maintained that the Amended Assessment was based on the 2014 Returns, and that it was not '*going back*'.

However, as is clear, this is at variance with the letter accompanying the Amended Assessment, which has been reproduced in paragraph [14] above.

The Amended Assessment: - Appellant's Position

[19] On 17 August 2016, the Appellant objected to the Notice of Amended Assessment. It stated *inter alia* as follows:

> '*It is essential to determine at the outset8 the circumstances under which the forgiveness of the debt took place. The forgiveness of the debt did not take place as part of the ordinary business of the company. On the contrary, it was part of an extraordinary event- a change in the shareholding and ownership of the company.*
>
> *Under the terms of this change, shares in the company held by existing shareholders (Lawrence Gale Hastings and Scilla Blackwell Hastings) were purchased by the new incoming shareholders (William James Maston and Kristin Thompson Maston).*
>
> *The transaction was therefore a capital transaction, not a revenue transaction;*
>
> *Under the terms of the sale and purchase agreement, all liabilities of the company as at the date of change in shareholding, were to remain with, and were to be the responsibility of the company's outgoing shareholders. Apart from other sundry liabilities, these liabilities were in the main, amounts that were owed to the outgoing shareholders.*
>
> *The existence of these liabilities and who would pay for them had a direct impact on consideration payable for the company's shares. There were 2 scenarios*
>
> - *Liabilities to remain and to be payable by the company and the new shareholders -consideration payable for the shares would be correspondingly lower.*
> - *Liabilities not to be payable by the company and to remain with the outgoing shareholders- consideration payable for shares would have been correspondingly higher.*

The latter scenario was adopted.

Prior to the sale and purchase agreement being entered into, these liabilities were recorded and reflected by Rainbow Reef Enterprises Limited as part of the liabilities of the company. On the basis that these liabilities were no longer payable by the company, as a result of the capital transition entered into between the outgoing and incoming shareholders, the liabilities were transferred to a capital reserve.

It is submitted that the accounting treatment adopted appropriately reflects

- *The capital nature of the transaction that was entered into, and*
- *The basis that resulted in the liabilities no longer being payable by the company.*

It is further submitted that the capital reserve appropriately reflects the consideration paid by the incoming shareholders for the acquisition of the company's shares and their equity in the company."

[20] On 16 January 2017 the Respondent issued its Objection Decision (RHC 60), whereby it dismissed the Appellant's objections *in toto.* Its reasons for dismissal were as follows:-

"Section 11 of the Income Tax Act (ITA) Cap 201 preamble narration states:

"For the purposes of this Act, total income means the aggregate of all sources income including annual profit or gain…

Profits from a trade or commercial or financial or other business or calling or otherwise howsoever.

Profits directly or indirectly accrued or derived from any other investment and whether such gains are divided or distributed or not…

The gain arising from the debt forgiven (Capital reserve of $533,717.00 resulting from the change of shareholding) is taxable under Section 11 ITA (Cap 201)".

[21] On 14 February 2017, the Appellant filed an Application for Review before the Tax Tribunal, which then referred the matter to the High Court sitting as the Tax Court.

The proceedings before the High Court

[22] In the High Court, the Appellant's challenge to the Respondent's dismissal of its Objections to the Amended Notice of Assessment was on the following basis:

"1. That the Objection Decision was erroneous in this case for the following reasons:

(a) The Respondent failed to properly consider the Sale and Purchase Agreement for the sale of shares in the Applicant by Lawrence Gale Hastings and Scilla Black Hastings to William James Maston and Kristin Thompson Maston.

(b) Prior to the Sale and Purchase Agreement being entered into, the liabilities in question were recorded as part of its liabilities. On the basis of the said agreement and the capital transaction the said liabilities were no longer payable by the Applicant and therefore transferred to a capital reserve.

(c) There was no forgiveness of debt by the Applicant or alternatively the forgiveness of debt was not part of the ordinary course of business of the Applicant.

(d) The Transaction in question was not a revenue transaction but was of a capital nature.

(e) Section 11 of the Income Tax Act does not give the Respondent any basis to deem a capital transaction as a revenue transaction.

(f) The Respondent wrongly treated this as: -

(i) Profits from a trade or commercial or financial or other business or calling or otherwise howsoever…

(ii) ...Profits directly or indirectly accrued or derived from any investment and whether such gains are divided or distributed or not…

1. That the Objection Decision did not properly consider the Objection of the Applicant."

Issues for determination before the High Court

[23] The issues for determination by the High Court were recorded as follows:

> *(1) Whether the forgiveness of debt can be regarded as taxable income under section 11 of the Income Tax Act in this case when it was not in the ordinary course of business?*
>
> *(2) Whether forgiveness of debt in this case should be treated as a capital transaction?*

The Evidence before the High Court

[24] Two witnesses testified on behalf of the Appellant; its Accountant Mr. Whiteside and one of its current shareholders Mr. Maston. The Respondent did not lead any evidence.

[25] Mr. Whiteside was a Member of the New Zealand Institute of Chartered Accountants and the Fiji Institute of Chartered Accountants. He had qualified as a Provisional Member of the New Zealand Society of Accountants in 1980 and had been admitted as a full Member in 1984. I consider his testimony as expert evidence. He testified that he operated his firm of Chartered Accountants in Fiji and had been practising in Fiji since 1984. He had been providing his services to the Appellant since the 1990's, and had been submitting its annual Tax Returns. He testified that when the shares were transferred from the original to the present shareholders, the understanding was that the original shareholders would be responsible for the liabilities of the Appellant and that the Income Tax Returns for 2002

were prepared on that basis. The witness had signed the Tax Returns of the Appellant in the capacity of its Tax Agent. In 2002, there was no Capital Reserve. This was evidenced by the fact that after the transfer of the shares, the financial statements revealed that the overdraft due had been reduced to zero. He testified that upon the liabilities being discharged (by the previous shareholders), they were considered to be a capital transaction, and that he considered this to be the proper accounting treatment. The sale and purchase of shares is a capital transaction, and advances by shareholders to a company are considered as a capital transaction. This was noted in Note 3 in the financial statements. It was included as such even in the tax returns for 2016.

[26] Most significantly, Mr. Whiteside testified that at the time the transaction took place, (and which would also cover the period when the tax returns were prepared), there was no statutory provision dealing with a 'forgiven debt", and that the accounting treatment accorded to the discharge of liabilities by the shareholders, was ''accepted accounting treatment''. In cross-examination, he said that the Appellant Company was not a party to the sale of the shares; the bank overdraft, land deposits, loans and advances being liabilities that had been incurred in respect of the day-to-day operations of the Appellant and that the funds provided enured to the benefit of the Appellant.

[27] The relevant extracts of Mr. Whiteside's testimony on this matter was as follows:

Mr. Nagin: *Now at the time this transaction happened there was, are you aware whether there was any statutory provision referring strictly or directly to forgiveness of debt?*

Mr. Whiteside: *I was not aware of that, My Lord this was accepted accounting and taxable treatment that was in place at the time and it continued to be in place from 2003 until 2016.*

[28] In cross-examination by learned Counsel for the Respondent, Mr. Whiteside testified that a loan from a shareholder to the company was a capital transaction. That evidence was as follows:

Mr. Singh: *Still at Tab 10, page 3 balance sheet. The advance from shareholders is listed as current liabilities and therefore Mr. Whiteside I put it to you that the advance form the shareholder is a liability and not a capital account?*

Judge: ***You understand the question?***

Mr. Whiteside: *My Lord, the fact that an item is listed as a liability does not make it a revenue or capital account; it is an asset or a liability.*

Mr. Singh: *Mr. Whiteside, in general terms about (sic) did the company benefit or gain in any manner from this forgiveness of debt?*

Mr. Whiteside: *The funds would have initially be (sic) provided by the shareholders to allow the company to carry on its businesses, My Lord. Very much in the same manner share capital its shareholders.*

Mr. Singh: *Mr. Whiteside, this yes or no question. Did the company benefit from this forgiveness of debt, simple yes or no answer?*

Judge*:* ***Did it benefit the company or did it not benefit the company?***

Mr. Whiteside: *It benefitted the company.*

Mr. Singh: *Thank you Mr. Whiteside. That concludes my questioning My Lord. Thank you.*

[29] Finally, Mr. Whiteside also drew the attention of the court to clause 3.02 (c) of the Sale and Purchase Agreement which stated as follows: "*the Vendors shall hand to the purchasers if necessary an acknowledgment that neither the directors nor secretary have any claim against the Company on any account whatsoever*", and clause 6.03 of the Sale and Purchase Agreement, which provided that; *"the Vendors shall indemnify and keep indemnified the Purchasers in respect of all claims and demands the Company for matters arising prior to the Completion Date*. In cross-examination when asked how a loan from a

shareholder is listed in the accounts of a company, his response was that all items would be either assets of liabilities, but that *per se*, did not make it either a capital or revenue account. He confirmed the position that the change in shareholding would not take away the liabilities of the company. Finally, he specifically testified that the way in which, or the purpose for which a company utilizes funds, would not be determinative of the nature or source of the funds.

[30] The second witness for the Appellant was one of the new shareholders, Mr. Maston. He testified that his wife and he had purchased the shares of the Appellant company from the previous shareholders, the previous shareholders agreed to take over the existing liabilities of the company, the taking over of those liabilities was recorded in capital reserve, this was done on the advice of his Accountant Mr. Whiteside, who had acted as the Appellant's Accountant even before the witness had purchased the Appellant company. Mr. Maston specifically testified that the price for the shares was based on the discharge of the existing liabilities by the previous shareholders. (RHC 429).

[31] It is undisputed that the categories of liabilities discharged by the previous shareholders were as follows:

> "*Bank Overdraft*
> *Accruals*
> *Advances from shareholders*
> *Land Deposits*
> *Loans and Advances*
> *Provision for the Vat*
> *Income Received in Advance"*

[32] The thrust of the Respondent's submissions was that the Appellant received a '*gain'* by the former shareholders taking over and discharging the Appellant's liabilities. In paragraph 5.1 of the written submissions in the court below, the Respondent admits that the listed liabilities that were taken over are '*revenue in nature and are directly associated with the revenue generating activities of the Applicant.*" The argument was that the Appellant incurred a gain from the forgiveness of the debt; the liabilities were clearly revenue in nature, the forgiven debt cannot be regarded as capital in nature and the creation of the

Capital Reserve does not change the '*nature of the gain incurred'* by the applicant, it must be treated as revenue in nature and is therefore taxable. Accordingly, the Respondent argued that the liabilities that were discharged by the previous shareholders resulted in *'gain'* and that section 11 was *'wide enough'* to capture such gain, under the definition of *"income"* or *"gain"* in section 11 of the Act.

The Judgement of the High Court

[33] The High Court's findings can be summarised as follows:

(i) the taking over of the Appellant's liabilities by the former shareholders, resulted in *'financial relief'* to the new *shareholders*;

(ii) the Appellant has a *new source of income* which it can utilize for generation of income;

[34] Reproduced below are extracts of the judgment to aid in the analysis of the reasoning and findings of the court below.

> *16. The whole basis for the accounting treatment of the transaction concerned appear (sic) to have been misconstrued by the Applicant's tax agent. They state their position in the Objection to Assessment dated 17 August 2016. On page 2 at para 1 they say under the terms of the SPA all liabilities of the Applicant are to remain with and be the responsibility of the outgoing shareholders (Vendors). Then at para 2 they say the scenario adopted was that the liabilities were not to be payable by the Applicant but to remain with the outgoing shareholders. This flys (sic) in the face of clause 3.02(c) of the SPA which I have found to establish the extinction of any claim by the Vendors/shareholders against the Applicant. Therefore it cannot be true that there are any liabilities extant. Nor can there be any sound economic reason to consider this now non-existent liability as worthy of being considered as capital under any name.*
>
> *17. The accountants are attempting to characterize this transaction as a capital transaction. But if I may say so with respect, they have to provide the legal cover for it to escape being considered as a revenue transaction. In my opinion they cannot try to achieve their objective by clothing the transaction as one which is capital in nature. The plain unvarnished truth is*

that by the Agreement for Sale and Purchase of Shares the Vendors have taken upon themselves the responsibility of shouldering the Applicant's liabilities and freeing the Applicant of these liabilities. They have thus obtained a greater gain then they would otherwise have obtained.

[35] The conclusion of the High Court runs like this:

> *18. Be that as it may, to my mind the end result of the transaction is that the Applicant now has a source of income for it to utilize in the generation of income in the course of their business. That this also simultaneously is a financial relief for the new shareholders/owners of the Applicant does not by some accounting sleight of hand convert it into capital as opposed to revenue in nature.*
>
> *19. I am of opinion that while an accountant might consider forgiveness of debts as capital for accounting purposes, the court does not have to follow suit. This is because "It is well settled, however, that the mere way in which a company keeps its accounts is not conclusive in the matter" per Cameron J. in : Geo. T. Davie and Sons Limited v. Minister of National Revenue (54 DTC 1045) 1954. For tax purposes I am constrained to treat it as revenue and therefore subject to be taxed.*

[36] To arrive at this conclusion, the learned Judge relied on the dicta of Cameron J in **Geo. T. Davie & Sons Ltd v Minister of National Revenue** (54 DTC) 1954, an authority relied on by the Appellant. However, although the learned Judge relied on that portion, with respect, that was not the *ratio* of the judgment, and more will need to be said of that later in this judgment, when I deal with the grounds of appeal separately.

[37] In regard to the precedents cited by the Appellant, the learned High Court Judge distinguished them on the basis that in this case there had been no cancellation of a trade debt, but a sum of money was now '*available to the Appellant'* and that this was therefore income. The learned Judge therefore dismissed the Application of the Appellant. I might state right away, for the reasons I will give below, that this was not correct.

Grounds of Appeal

[38] The grounds of appeal urged by the Appellant before this court are reproduced below. They are: -

1. *The Learned Judge erred in law and in fact when he held that the forgiveness of debt in this case was a source of income for the Appellant and taxable under Section 11 of the Income Tax Act.*
2. *The Learned Judge erred in law and in fact in not properly considering that the forgiveness of debt was intrinsically linked to the Agreement for Sale and Purchase shares and was a one-off transaction of a capital nature.*
3. *The Learned Judge erred in Law and in fact in not properly accepting the accounting evidence of Gardiner Henri Whiteside especially when he was the accountant of the Appellant since 1990 and throughout the relevant period and there was no contradictory accounting evidence.*
4. *The Learned Judge erred in law and in fact when he failed to properly consider that the transaction in question happened on 22nd October 2002 and the Respondent issues its Notice of Amendment Assessment on 30th June, 2016 for the year ending 31st December, 2014 and therefore was well out of time.*
5. *The Learned Judge erred in law and in fact in not properly considering and applying the authorities that were referred to him.*

Grounds 1 and 2:- the meaning of 'total income' and 'gain'

[39] It is convenient to deal with grounds one and two together because they are linked. The primary matter for determination is whether the discharge of company's liabilities by the shareholders of a private limited liability company, results in the company having "*accrued or derived an annual profit or gain*", within the meaning of section 11 of the Income Tax Act of 1974, or whether it is in substance an infusion of capital by the shareholders, which is recognisable as a capital reserve.

The Applicable Law- Income Tax Act 1974

(a) Statutory definition- The meaning of 'total income' for the purposes of section 11 of the Income Tax Act

[40] Section 11 of the 1974 Act provides as follows:

> '***Definition of total income or gain***
>
> *11. For the purpose or this Act, "total income" means the aggregate of all sources of income including the* ***annual net profit or gain*** *or gratuity, whether ascertained and capable of computation as being wages, salary or other fixed amount or unascertained as being fees or emoluments or as being profits from trade or commercial or financial or other business or calling or otherwise howsoever, directly or indirectly* ***accrued to or derived*** *by a person from any office or employment or from any profession or calling or from any trade, manufacture or business or otherwise howsoever, as the case may be, including the estimated annual value of any quarters or board or residence or of any other allowance or benefit provided by his employer or granted in respect of employment whether in money or otherwise, and shall include the interest, dividends or profits directly indirectly accrued or derived from money at interest upon any security or without security or from stock or from any other investment, and whether such gains or profits are divided or distributed or not, and also the annual profit or gain from any other source including the income from, but not the value of, property acquired by gift, bequest, devise or descent, and including the income from, but not the proceeds of, life insurance policies paid upon the death of the person insured, or payments made or credited to the insured on life insurance, endowment or annuity contracts upon the maturity of the term mentioned in the contract:'* (Emphasis added).

[41] The words "*annual net profit or gain'* in section 11 are followed by the phrase;

> *'directly or indirectly accrued to or derived by a person from any office or employment or from any profession or calling or from any trade, manufacture or business or otherwise howsoever'*

[42] It is to be noted at the outset that the Act does not define 'income'. Instead it sets out all sources of income which are included in section 11, and states that it is so, *"for the purposes of this Act"*.

[43] *'Income year'* is defined as follows:
"Income year" means, in respect of the income of any person, the year in which that income has been derived by him; (emphasis added).

[44] Section 6 is the charging section for '*Basic Tax'*.

[45] Section 7 provides for the charging of '*Normal Tax'*. It provides as follows:

> *6. (1) Subject to the other provisions of this Act, there shall be assessed, levied and paid a tax, to be known as "normal tax", for each year of assessment on every dollar of chargeable income of-*
>
> *(e) any other company in respect of its chargeable income derived during the year preceding the year of assessment.* (Emphasis added).

[46] The contention of the Respondent is that section 11 of the Income Tax Act No.6 of 1974 ('***the 1974 Act'***) is '*wide enough'* to cover the impugned assessment. I must state at the outset of seeking to determine this matter, that except for the reference to the words *'wide enough'*, there was no explanation or illustration forthcoming from the Respondent to justify the legal basis of the impugned Amended Assessment.

(b) Judicial definition of "income"

[47] *Etymologically, the word 'income' means 'that which comes in or has come in* 'said Lowe J in **Re Income Tax Acts** (No2) VLR 233; [1930] R & McG 273 at 281.

[48] In **Re Spanish Prospecting Co Ltd** [1911] 1 Ch 92 at 98: Moulton J said:

> *"Profits implies a comparison between the state of business at two specific dates usually separated by an interval of a year. The fundamental meaning of the amount of the gain made during the year. This can only be ascertained by a comparison of the assets at two dates."*

[49] The economic concept of income is different from the judicial concept of income. What is assessable for income tax is ordinary income, as well as statutory income, that is, sources of income which are, for tax purposes statutorily regarded as income.

[50] The Appellant's argument was that, at the time the Additional Assessment was issued, the law did not recognize a '*gain'* in the nature of a forgiven debt, to be income.

[51] As is evident from paragraph [27] of this judgment, '*Advances from Shareholders'* was only one of the heads of liabilities that the Appellant had, at the time of negotiation of the sale of the shares. In this case, the former shareholders discharged the totality of the debts of the company in which they owned all the shares. Thus, to start with, this was not a case in which a creditor forgave a liability of a creditor. The shareholders discharged the entirety of the Appellant's liabilities, which included liabilities the Appellant owed to other creditors. This will be elaborated below.

[52] The question then is, whether the discharge of such liabilities, was captured within the parameters of section 11, so as to make it an annual net profit or gain, assessable and taxable under section 11 of the Act.

[53] To support the contention that the discharge of its liabilities by its shareholders was not captured under section 11 of the ITA, the Appellant relied on the judgment of the House of Lords in **The British Mexican Petroleum Company Ltd v Jackson (H.M. Inspector of Taxes) (2) (**1929-1932) 16 TC 570. I must state at the outset that I did find, that after the concept of 'forgiveness of a commercial debt' came to be statutorily recognized in specific instances, in several jurisdictions, including the United States, Canada and Australia, the courts in those jurisdictions have distinguished the case of **The British Mexican Petroleum Company Ltd** *(supra),* when tax payers sought to rely on it. In my view that had to be necessarily so, because the statutory recognition of the forgiveness of a commercial debt, placed the matter beyond doubt or controversy. However, in my view, the same cannot be said of the Income Tax Act of 1974, which stood un-amended until 2015. Therefore, the impugned Additional Assessment in this case, stands on a different footing.

[54] In **The British Mexican Petroleum Company Ltd v Jackson (H.M. Inspector of Taxes)** (*supra*), the appellant company whose business was the buying and selling of oil, had entered into a contract with an American oil producing company. Under the contract, the appellant had bound itself to buy oil from the American company, as well as to hire ships to transport the oil. In 1921, the Appellant ran into a large amount of debt to the oil supplier, the ship owner and the ship builder who was building the ships that were transporting the cargo; it was thus indebted to a total of three creditors. The oil company and the shipbuilding company were related parties. The creditor companies executed an agreement which resulted in the release of the appellant from its debts. The appellant transferred the sums released into its Balance Sheet and entered in a separate "*Reserve as at 31 December 1922*". The Revenue wanted to re-open the accounts for 1921, and the appellant challenged this. The question that arose for determination was whether the sum written off must be reckoned for the purpose of computing the profits and gains of the appellant under the Income Tax Act, 1918 either by reducing by that amount the debit item in the trading account to 30 June 1921, or by crediting it a trading receipt in the trading account to 31 December 1922.

[55] In dismissing the Crown's appeal, the House of Lords held that the account ending on 30 June 1921, could not be reopened, as the amount of the liability had been correctly stated at the time, and the funds had been released on the correctness of those entries.

[56] The following passage illustrates the principle that liabilities are to be considered in the year in which they either arose or were extinguished. Lord Macmillan said at page 593:-

> *If profit and loss accounts were compiled on the basis of entering only sums actually received and sums actually paid, then the debt of £1,270,232, incurred by the Appellant Company to the Huasteca Petroleum Company, would never have appeared in the accounts of the Appellant Company, for it was never in fact paid. But business men do not so prepare their accounts either for their own purposes or for the purposes of the Inland Revenue, and debts incurred by a trader as well as debts which have become due to him, though in neither case yet paid, are properly taken into account in ascertaining the profits of the year. It is accordingly not questioned that in the accounts of the Appellant Company for the year to 30th June, 1921, the agreed amount of the indebtedness it had by then incurred to the Huasteca Company was properly entered as a debit item. It was not entered as a sum paid, but as a trading debt admittedly incurred. That being so, the circumstance that the creditor subsequently forgave part of the debt and agreed not to exact the full amount of it affords no justification for reopening the account for the year to 30th June, 1921, and substituting for the amount then legally due the lesser amount which the creditor was subsequently content to accept. An account may be reopened where an item has been omitted or some other error has occurred, or an account may be kept open by describing entries in it as provisional, but here it is agreed on all hands that there was no error in the accounts of the Appellant Company for the year to 30th June, 1921, and that they were properly and finally drawn up so as to show the result of the year's trading. If, then, the accounts for the year to 30th June, 1921, cannot now be gone back upon, still less in my opinion can the Appellant Company be required to enter as a credit item in its accounts for the eighteen months to 31st December,*

1922, the sum of £945,232, being the extent to which the Huasteca Company agreed to release the Appellant Company's debt to it. I say so for the short and simple reason that the Appellant Company did not, in those eighteen months, either receive payment of that sum or acquire any right to receive payment of it. I cannot see how the extent to which a debt is forgiven can become a credit item in the trading account for the period within which the concession is made. (Emphasis added).

[57] The Appellant also relied on **Geo Davie and Sons Ltd v Minister of National Revenue** 54 DTC 1045. In that case the facts were that the appellant a Canadian company, was in the business of building and repairing ships and vessels. It had a contract with a Chinese company to build and deliver vessels. The Chinese company financed the contract with loans guaranteed by the Government of China. The Government of Canada guaranteed the undertaking of the Government of China. The appellant got into financial difficulty and was unable to fulfil its contractual obligations. Thereafter, the appellant entered into an agreement described as a "*Deed of Loan and Mortgage*" with the Canadian Commercial Corporation *"(C.C.C.)"* Prior to that date the C.C.C had loaned the appellant a sum of $ 450,000. In the Deed, the appellant was referred to as '*the Borrower'*, and CCC as '*the Lender'*. There was a clause mortgaging the immovable properties of the Borrower to the Lender for monies that may be advanced in the future. Consequently, the Government of Canada abated a total sum of $734,813.83 out of the Total Advance of $914,000.00. The sum of $734,813.83 was made up of the following: (a) $284,813.83 which was the amount of payment received by the CCC from the Chinese company (representing the increase in the price of 3 additional vessels); and (b) a sum of $450,000.00 being a portion of the advances made by the CCC to the Appellant under mortgage security, and representing the portion of the loss assumed by the Canadian Government under the shipbuilding agreement.

[58] The Revenue then added to the appellant's declared income for the year 1949 the sum of $450,000.00, which was the sum by which the indebtedness of the Appellant had been abated. The appellant submitted that the relationship between the Government of Canada

and it were debtor and creditor on capital account, and that the abatement of the debt could result only in a capital gain. In its Income Tax Return for 1949, the appellant did not show the sum of $450,000.00 as a trading receipt, but as an increase in its capital surplus. The Crown argued that the result of abatement of the debt by the Government was an addition to the income of the Appellant. However, the Crown conceded that the advances by CCC to the Appellant were advances of capital.

[59] Having followed the precedent in the **British Petroleum** case (*supra*), the Exchequer Court of Canada held as follows:

> *"...the benefit conferred on the appellant by the abatement of its capital liability was not something received in the course of its normal trading operations. It was outside those operations entirely. Moreover, to adopt the language of Lord Macmillan, it did not in 1949 receive the payment of the sum of $450,000.00 or acquire a right to receive it. The liability was diminished purely by an act of grace, coupled possibly to some extent with matters of public policy and business motives. The benefit received by the appellant was not a profit from its business."* (Emphasis added).

[60] In the case of **GeoT. Davie & Sons** (*supra)*, the court recognized that the facts presented were somewhat different from those in the case of **British Petroleum** (*supra*), in which the debt that was abated was incurred in the ordinary course of trading. Despite that however, it recognized the conceptual distinction between income and capital. **In British Petroleum** (*supra*) the principle that was upheld was that the cancellation or abatement of an undisputed trade debt does not give rise to taxable income in the hands of the tax payer.

[61] During the course of the hearing before this court, the learned Counsel for the Respondent did not specifically counter the submissions of the Appellant in respect of the two authorities cited above. In paragraph 4.1 and 4.2 of its written submissions, the Respondents stated that "the *forgiveness of debt was a source of income for the Appellant. There was gain as a result of the sales and purchase of shares under the sales*

and purchase agreement.' The forgiveness of the debt cannot be regarded as a capital transaction as the liabilities or debts that were forgiven are revenue in nature".

Analysis of the components of section 11 – profit or gain, accrued or derived.

[62] The key words contained in section 11, which require analysis are *'profit or gain'*, "*accrued to or derived by a person*". An examination of the words in section 11 is required. Tax is chargeable on "*total income*". Total income means the aggregate of all sources of income. To this, is added the words '*the annual net profit or gain*. I stop here to consider these words.

[63] The word *'annual'* applies to both *'profit'* and *'gain'*. Thus, what the legislature has specifically included is *annual profit or gain*. In my view, this first means that whatever profit or gain is being considered, it must be of an annual nature. A reading of the entire section, taking into consideration the punctuation contained therein, leads me to the conclusion that the word *'gain'*, cannot be read in isolation, it requires to be read as profit or gain arising from one of the sources or activities specified in section 11. In other words, the profit or gain ought to have been received in the course of having carried out a trade, or commercial or financial or other business or calling, in a repetitive manner. It shuts out isolated transactions of a non-recurring nature.

[64] Further, the word *'gain',* follows the word "*profit"*. It does not say ***'a gain',*** and this is significant. Had the word '*a*' preceded the word "*gain",* it may have been arguable that any type of gain is captured under section 11. However, I am not prepared, in the absence of specific words in the Act, to hold that a transaction which was a capital transaction and had not been suspected of having been an evasive devise, could be reasonably included under the framework of section 11. Besides the words gain, must be read *ejusdem generis* with the word profit. Although there is only one word *'gain'*, which follows the word *'profit'*, In my view, the word *'gain'* must take its colour, from the word *'profit'.*

[65] In Section 11, gain is not used in the sense of a noun, in the abstract or as in the general sense of benefit or increase in wealth or resources. It envisages and covers an annual profit or gain, as opposed to an annual loss. Thus, the word '*gain'* cannot be considered in isolation, so as to argue that the Appellant gained something by its debts being discharged by its shareholders. The Respondent's entire case, namely, the impugned Additional Assessment is based on the word '*gain*' in section 11. For the reasons that I will explain below, this is without merit.

[66] For the sake of completeness, and because I need to deal with the submission of the Respondent that the words in section 11 are, "*wide enough*" to capture the transaction which is the subject of this case, I proceed now to consider the other provision of section 11, under its different components. The words, *'gratuity, whether ascertained and capable of computation as being wages, salary or other fixed amount or unascertained as being fees or emoluments',* refer to money which is a return for services performed or labour expended. Clearly, the gain or benefit received by the Appellant does not come under this.

[67] The words '*or as being profits from trade or commercial or financial or other business*" are no doubt, wide. They include profits from a trade or business, which implies that the activity must have been systematically carried on and exercised, and would not apply to an isolated transaction. Here again, what took place in this case, cannot be captured under these words.

> *"There can be no definition of the words 'exercising a trade' is only another mode of expressing 'carrying on a business', but it certainly carries with it a meaning that the business or trade must be habitually or systematically exercised and that it cannot apply to isolated transactions"* per Lord Morris in **Graninger & Son v Gough** 3 TC 462

[68] The words "*or calling or otherwise howsoever, directly or indirectly accrued to or derived by a person from any office or employment or from any profession or calling",* refer to profits from employment or from the rendering of professional services. The benefit or gain that was received by the Appellant, would not be captured under these words either.

[69] The words "*or from any trade, manufacture or business or otherwise howsoever, as the case may be,",* taken in the context of this appeal, as urged by the Respondent means this; if the Appellant was in the business of trading in shares, then the monies received on the transfer of shares would be captured within these words. However, it was not the Appellant Company that sold the shares, it was the owners of those shares, and the company was indeed removed from the sale. To hold otherwise, would be to ignore the very basic principle of corporate personality.

[70] The words; *"and shall include the interest, dividends or profits directly indirectly accrued or derived from money at interest upon any security or without security or from stock or from any other investment, and whether such gains or profits are divided or distributed or not,"* are clear, and are not related to the issue in this appeal.

[71] The words:

> *"and also the annual profit or gain from any other source including the income from, but not the value of, property acquired by gift, bequest, devise or descent, and including the income from, but not the proceeds of, life insurance policies paid upon the death of the person insured, or payments made or credited to the insured on life insurance, endowment or annuity contracts upon the maturity of the term mentioned in the contract:"*

despite being wide in range, contains the word '*annual'* thereby excluding an isolated transaction, as was the case here.

The meaning of "Gain" in Section 11 of the Income Tax Act 1974

[72] A matter that now needs consideration is whether the word *'gain'*, could be applied to the discharge of the liabilities of the Appellant by its shareholders so as to bring it under section 11. The answer to that question must begin from an understanding of what type of company the Appellant was. It is significant that it was a private limited liability company. The shareholders who discharged all its debts owned all the shares in it. Thus,

the economic reality is that it amounted to an infusion of capital, and it was in substance, equity. I have no doubt in my mind, that the discharge of the debts by the shareholders of a private company, in substance is equity, and is a capital transaction.

[73] Despite the possible argument or theory that if a gain is capable being converted into money in a practical and commercial sense, it may constitute assessable income, in my view it would also have to be gain that is annual and not one that flows from an isolated or one-off transaction. More importantly, it would have to statutorily recognized.

[74] If a statute specifically brings a specific gain into assessable gains, as in the case of capital gains, then such gain is taxable. It does not become profit or gain under the heading of 'income' under the definition of what is known as 'judicial income', but could be recognized as a gain that is liable to be taxed, but as a gain on capital. That is quite a different matter from what is at issue here.

[75] In this case, the tax payer is the Appellant Company. Its business was the development and sale of land. Can it be claimed that the discharge of its existing liabilities by its shareholders, was a profit or gain, accrued or derived in the course of its trade or business? I think not. In fact, it was quite the reverse. In the course of carrying on its business, it ended up with liabilities. It was these liabilities that were discharged.

[76] It cannot be argued that those liabilities arose in the course of carrying out its business, and there would have been profits made, because those transactions would have been concluded and recognized in the financial statements in the relevant tax period.

The meaning of "accrued" in Section 11 of the Income Tax Act 1974

[77] Black's Law Dictionary (Tenth ed.1995) defines '"Accrued Income" as follows:

"*Money earned but not yet received."*

An example of such income is rental, interest or commission income which has accrued because it has been earned but has not, for some reason, been received. But because it is

due to come in, it is recognized as a source of income. So, it has to be recorded in the period in which it was earned, although it would be received in a different accounting period. In my view, it is beyond doubt that when the shareholders discharged the liabilities of the Appellant, there was nothing earned, even notionally. It cannot possibly be argued that the discharge of its liabilities is recognized within the meaning of section 11 of the Act, as a profit or gain accrued or derived from one of the heads of income contained in section 11 of the Act.

The meaning of "derived" in Section 11 of the Income Tax Act 1974

[78] The next word that requires consideration is *'derived'*. It means to obtain or receive from a source. It means to draw from a source. But above all, in my view, the word *derived* is linked to the words "*profit or gain"*. One cannot simply assume that merely because liabilities were reduced, the company had 'gained' or 'derived income' in the sense contemplated in section 11 of the Act.

[79] In the context of what took place in this case, in my view, when the liabilities of the Appellant were discharged, the word 'gain' could not have been simply applied to the Appellant in order to issue an additional assessment. The word *'gain'* does not exist in a vacuum. Instead, the concept of total income is linked to profit or gain. The Respondent has not satisfied this court that the discharge of the Appellants liabilities by the shareholders came within this provision.

[80] What then is profit? Put simply, it is income minus expenditure. But for tax purposes, it is income, which includes statutory income as well as judicial income, meaning sources which have been held to be income in by virtue of judicial determination. For tax purposes, it is only statutory deductions that are permissible to arrive at assessable income.

[81] What section 11 makes liable, is profit and gain that has accrued, or is derived from the several sources and incidents specified in section 11. Profit is not synonymous with income. Profit, for tax purposes, is that part remaining after deducting permitted

expenditure and making allowances as permitted by tax law. Thus profit for the purposes of accounting, and profit for the purposes of tax liability may not always coincide.

[82] The use of the words '*gain'* in section 11 after the word income, may well, at first blush, appear to bring within its ambit any gain, in a general, abstract sense. However, I do not think that that even a permissible interpretation of section 11, can in law, include within its scope the situation we have in this case. To accept the argument of the Respondent would be to read into the Act, something that clearly is not capable of being included, doing violence to the principle that one can be taxed only by clear words in a statute. If Parliament intended to tax a 'benefit' which results from a debtor being relieved of repayment of his or its liabilities, it would have said so in plain words. This, it did only in the 2015 Income Tax Act.

[83] It is material to note that in the court below, the Respondent's closing argument was that the Appellant had received a 'benefit', and that section 11 was 'wide enough' to capture 'such a benefit', to the extent that such benefit was deemed to be *gain'*, and therefore assessable. For the reasons I will set out below, I am compelled to reject that position because it took the argument away from the specific words 'gain' in the Act, and introduced the word 'benefit' which is not only ambiguous, but misleading too, and exacerbated the matter further, by ignoring the rules of interpretation that courts in many Common Law jurisdictions have, over the years, thought proper to govern the interpretation of fiscal statutes. I find useful the following extract from the speech of Lord Cairns who observed in **Partington v Attorney General** (1869) LR HL 100 as follows:

> *"As I understand the principle of all fiscal legislation, it is this: If the person to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free; however apparently within the spirit of the law, the case might otherwise appear to be. In other words, if there be admissible, in any statute, what is called an*

equitable construction, certainly such construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute".

[84] The burden of proving that the assessment is excessive lies on the tax payer. However, the burden of proving that the subject comes clearly within the provisions of the law lies on the state. In my view, in this case the Respondent has not discharged this burden. In regard to the standard of proof required of the state, in a tax case, it is useful to remind ourselves of the well-known dicta of Rowlatt J in **Re Cape Brandy Syndicate** [1971] 2 WLR 39, p.42, who said:

"Now of course it is said and urged by Sir William Finlay that in a taxing Act clear words are necessary to tax the subject. But it is often endeavoured to give to that maxim a wide and fanciful construction. It does not mean that words are to be unduly restricted against the Crown or that there is to be any discrimination against the Crown in such Acts. It means this, I think; it means that in taxation you have to look simply at what is clearly said. There is no room for any intendment; there is no equity about a tax: there is no presumption as to a tax; you read nothing in; you imply nothing, but you look fairly at what is said and at what is said clearly and that is the tax."

The definite inclusion of forgiven debt: The Income Tax Act No.32 of 2015

[85] Looking at a subsequent version of an earlier statute, in order to interpret an earlier statute, is not a recommended practice. It is permissible and done only in narrow situations.

[86] I find assistance in the following passage:

"For a later statute to become relevant there must be something obscure and ambiguous or readily capable of more than one interpretation… If such an ambiguity can be found, it becomes permissible to look at the later Acts "not perhaps to construe the earlier statute, but to see the

meaning which Parliament puts on the self –same phrase in a similar context in case it throws any light on the matter." (Maxwell on the Interpretation of Statutes, p.70, Twelfth ed. 1976).

[87] For the reasons I will set out below, I find that in this case, I am justified in traversing this path.

[88] The undeniable fact in this case is that despite the Appellant's annual Tax Returns disclosing the discharge of liabilities under 'Capital Reserve' from as far back as 2003, it was only on 8 June 2016, after the enactment of the Income Tax Act 2015, which became operative on 1 January 2016, and which specifically included '*forgiven commercial debt'* for the first time, that the Respondent decided to go back into the 2003 Returns and issue an Additional Assessment. In fact, both Counsel were heard to say so, and indeed in paragraph 4.6 of Respondent's written submissions in this court he specifically states as follows:

> *"4.6 The Respondent humbly submits that the Respondent did not assess the Appellant in 2003 however there was an amendment in 2014."*

[89] Further, learned Counsel for both the Appellant and the Respondent submitted that the 2015 Act, specifically included a forgiven debt as a source of income. Thus, a shift in policy was specifically translated into legislation. The 2015 Act has, under the broad head of income, recognized several sub-heads or sources such as employment income, business income and property income; and is more detailed in terms of what is subsumed under the different heads or statutory sources of income.

[90] The relevant definitions in the 2015 Act are as follows: -

"Gross income" has the meaning in section 14;
Income" means employment income, business income, property income, income referred to in section *14(1) (b) or (d), and deposits referred to in section 14(1) (c);*

[91] From then onwards, the legislature has specifically provided for "*a commercial debt that is forgiven"* to be regarded as income. Thus, the statutory definition of income in the 2015 Act has gone beyond the ordinary concept of income. In these circumstances, I am further fortified in my view that the 1974 Act under which the impugned Additional Assessment was issued, was not 'wide enough' to cover the release of the debt by a former shareholder of the Appellant so as to bring it within the words '*gain'* in section 11 of the Act. To hold otherwise, would be to ignore the significance of the words income or gain, and result in absurdity.

[92] More importantly, in the interpretation of fiscal statutes, tax liability cannot be imposed by analogy or extension. That was what was sought to be done by the Respondent in this case as reflected in its argument that Section 11 was *'wide enough'* to capture the situation in this case.

[93] To conclude this ground of appeal, I go back to **British Mexican Petroleum** (*supra*), in which it was the creditors who forgave the debt, by writing off the debts that were due to them. Despite this, the House of Lords rejected the argument for the Crown that such a transaction could be regarded as income. Whilst launching my analysis by adopting the principles of British Mexican Petroleum, in my view, the facts of this case go even beyond that. In this case, it was the shareholders who held all the shares in the company, who discharged the entity of the company's debts. It did not 'forgive' only those debts or to them. In my view, for a discharge of liabilities to be brought within the concept of forgiven debt, it must primarily take place between debtor and creditor. Unless a statute specifically recognises any other release of liability, there can be no forgiveness of debt by a person who is not a creditor. In this case, when the shareholders discharged the entirety of the company's liabilities it was in substance, an addition of equity. I therefore reject the submissions of the respondent.

[94] I also observe that finally, the learned Judge rested his conclusion on the words *'financial relief'* (vide paragraph 18. of the judgment), and in paragraph 24 he concluded by saying that *'here was a sum now available to applicant'.* Implied in this, is the understanding that

it was capital that was now available to the Appellant to generate further income. There lies the catch. It was capital, and not profit or gain in terms of section 11.

[95] For the reasons set out above, I hold that the extinguishment of the Appellant's liabilities did not amount to a profit or gain that is captured under the provisions of section 11 of the Act, and that the Amended assessment was without legal basis. I therefore reject the submissions of the Respondent, and allow ground one of the appeal.

Ground 2 - the sale and purchase agreement: capital transaction vs profit or gain

[96] It is undisputed that the Sale and Purchase Agreement relating to the sale of shares, was that the price paid for the shares was influenced by the discharge of the Appellant's liabilities by the previous shareholders, i.e. the Vendors. In considering this matter, in my view, it is useful to consider the position of shareholders in a private limited liability company. I do so because it appears to me, that there was insufficient consideration given to the significance of this matter in the court below, which probably led to its final conclusion.

[97] In view of the emphasis placed on the role of the shareholders in issuing the amended assessment, I consider it appropriate to set out a few basic matters in regard to the position of shareholders in a private limited liability company. Shareholders are usually not liable for the debts of the company, except to the extent of the nominal value of their shares. However, when a shareholder infuses capital into the company, that is identified as ownership capital. This then becomes the foundation for the creation of the company. These shareholders are the real owners of the company. Usually, shareholders do not have the right to manage the company. It is the Directors who manage the company, while shareholders have the right to be elected to sit on the Board of Directors of the company. Of course shareholders have a say in the management of the company. Shareholders have voting rights, and are entitled to receive profits in the form of dividends based on the directions of the Directors, who in law are the 'directing mind' of the company. Shareholders are ordinarily not liable for either criminal or civil which may

attach to a company. However, as in this case, the shareholders are also the owners of the company, and their discharge of the liabilities of the company, cannot be regarded as a gain within the meaning of section 11 of the Act, nor was it required to be regarded as a revenue transaction.

[98] The facts must be understood in their real chronological sequence because that impacts on the characterization to be given to extinguishment of the Appellant's liabilities. It is significant that the liabilities listed in the Financial Statements consisted of liabilities due not only to the shareholders, but to other creditors such as the bank, as well. By reducing the debt of the company, the owners in effect increased the value of the company's shareholder equity. In the Appellant's Objection to the Amended Assessment (RHC 56), the Appellant, categorically stated that the discharge of the existing liabilities by the former shareholders had a direct impact on consideration payable for the company's shares. The discharge of the entirety of the liabilities that existed at the time of the execution of the Sale and Purchase Agreement was a considered, and lawful commercial decision, to enable it to secure a better price for the shares. Therefore, the discharge of the company's liabilities by the owners reflected a capital transaction and was correctly placed in a Capital Reserve.

[99] If the money was not infused, may be the company could not have been sustained. This may have been a very real possibility. And, it is also a material fact in arriving at the decision as to whether it was a capital or a revenue transaction. The fact that in a general sense, it could be argued that the Appellant had been relieved by the discharge of its liabilities, which the learned Counsel for the Respondent in his final submissions in the court below categorized as a *'benefit'*, in my view insufficient to bring it under the meaning of *'gain'* in section 11 of the Act.

[100] In the circumstances of this case, the transfer of the amount of the discharged liabilities to 'Capital Reserve', in my view, does not offend the legal principles of recognition of the distinction between revenue and capital. Nor, was it contrary to the accepted

principles of accounting or the accounting treatment to be accorded to a transaction of this nature, as required by the Fiji Institute of Accountants.

[101] There is no doubt that the liabilities would have been connected to the revenue generating activities of the Appellant; but that does not render the discharge of those liabilities, a 'profit' or 'gain' as sought to be argued by the Respondents. If one were to go back in time, and re-live 2003, the year in which those liabilities existed and discharged by the shareholders, could it be reasonably said that it amounted to profit or gain in terms of Section 11? I think not. Whatever '*gain*' that the Appellant would have made at that time, had been recognized in the tax system, the relevant taxes paid in that regard at that time, and those matters are at an end.

[102] In the result, I hold that the result of the transaction by which the shareholders discharged the liabilities of the Appellant, was a capital transaction, was correctly recorded as 'Capital Reserve' in accordance with the applicable accounting treatment, there was no statutory recognition of the concept of a 'forgiven commercial debt' at the time the transaction was so recorded and reported by the Appellant. Accordingly, I reject the submissions of the Respondent, and allow ground two of the appeal.

Ground 3- effect of uncontradicted evidence of the Accountant

[103] The Fiji Institute of Accountants was incorporated under the Fiji Institute of Accountants Act of 1971. It is responsible for publishing and ensuring compliance with accounting standards. The official website of the Institute also reveals that it has in place a system of Peer Review for members who hold a Public Practicing Certificate ('***PPP'***). Its mandate is to ensure that its members comply with the relevant international standards in the preparation of accounts and financial statements, and this is done by adopting and incorporating the relevant standards which accountants must comply with in preparing financial statements.

[104] In the absence of any expert evidence contradicting the evidence of Mr. Whiteside in respect of the accounting policies adopted by the Appellant, there is no basis on which I can accept the finding of the learned Judge who in paragraph [19] of the judgment held that the accounting treatment of the company's accountant is not determinative of how the transaction should be characterized.

[105] The Appellant contended that the evidence of its Accountant was un-contradicted, but the learned Judge failed to give any effect to it. I accept this submission, as I find that the accounting treatment accorded by the Appellant's accountant was in accordance with the standards followed by the Fiji Institute of Chartered Accountants. There was no evidence to the contrary. Nor was this raised in cross-examination.

[106] In the context of this ground of appeal, I feel obliged to consider this matter by looking at the effect of evidence of an expert witness in respect of accounting treatment, if only to ascertain whether there had been due consideration in the court below, of the evidence relevant to the issue for determination. The thrust of the justification by the Respondent for issuing the impugned Amended Assessment was that, the mere accounting treatment accorded by the tax payer or his Accountant to an item of expenditure or income, would not be determinative of the tax liability that flows from it. Whilst there is authority for this as general proposition, the matter does not stop there.

[107] Despite that proposition being the crux of the Respondent's case, there was no expert or other evidence led to counter the evidence of the expert witness relied on by the Appellant, to establish that the accounting treatment followed by the Appellant was either prohibited or irregular in any manner. It was precisely because of this that it was incumbent on the Respondent to have led evidence if any, to rebut the Appellant's evidence, and to establish that the treatment accorded by the Appellant to the discharge of the liabilities, was improper or contrary to the Accounting Standards. I also do not find that in cross-examination, the testimony of Mr. Whiteside was demolished on any material matter.

Principles and practice of accountancy and relevance to tax liability

[108] How a company treats transactions in its financial statements, will not be determinative of the question as to whether it is income or gain which is revenue in nature, and whether it is profit or gain for the purposes of tax liability. However, unless the court finds that the accounting treatment accorded to a particular transaction is contrary to law, it will not lightly disregard it, or treat it as incorrect or unacceptable.

[109] In looking at the accounting concept of income, text writers say:

> "*Income arises from commercial activity, and the conceptual underpinning of commercial concepts has influenced the courts form time to time even though financial reports and net profit do not determine taxable income...*" (Understanding Taxation Law 2017, John Taylor, Michael Walpole, Mark Burtin, Tony Ciro and Ian Murray).

[110] Put simply, profit is the surplus by which receipts from trade or business exceed expenditure incurred in earning those profits. A basic rule of tax law is that tax is chargeable on a tax payer's real or actual profit. What is true profit is a question of fact. It has been described as follows:-

> *"It is plain that the question of what is or is not a profit or gain must primarily be one of fact, and of fact to be ascertained by the test applied in ordinary business. Questions of law can arise only when some express statutory direction applies and excludes ordinary commercial practice where, by reason of its being impracticable to ascertain the facts sufficiently. Some presumption has to be made to fill the gap." Per* Viscount Haldane in **Sun Insurance Officer v Clark** 6 TC 59.

[111] The application of generally accepted principles of accountancy is generally a matter of fact, and when there are competing approaches, it is a matter of interpretation for the court.

[112] Section 11 captures profits and gains accrued to, or derived from the various heads. In ascertaining profits and income, all expenses incurred in the production of such profits and gains are deductible. There are deductions that are permitted and those that are prohibited. There is no statutory definition of profit or gain. Accounts of commercial entities are prepared in accordance with general accepted principles of commercial accounting. To a large extent, the results of such accounts are the basis of tax for, subject to specific statutory provisions, if any, in respect of the determination of taxable profits.

[113] Accordingly, in my view, when the learned Judge rejected the accounting treatment accorded by the Appellants Accountant to the transaction under review, he did so without any real basis. Accordingly I allow ground 3 of the appeal.

Ground 4- time bar

[114] The Appellant had not raised this objection either before the Respondent in its original Objections, or in its Application for Review. It was also not raised as an Issue, in the court below. As I have already held that the Amended assessment was in substance without legal basis, it is not necessary for me to rule on this matter. However, before I part with this judgement I feel obliged to make a few observations on this matter.

[115] From any point of view, I find it impossible to understand what reason the Respondent would be able to proffer, if asked why the Appellant's Tax Returns were not once queried on this matter, between 2003 and 2015. In this case, there was no evidence that the Appellant had misreported any facts, or had made a false return, although the Respondent simply said so in the Amended Assessment. There was also no allegation of evasion. Thus, even if the Appellant had taken the objection of delay at the relevant time, it is difficult to see how the Respondent would have been able to overcome this. Legal

certainty is a limb of the Rule of Law that cannot be ignored in the administration of taxes. I find the resurrection of the contents of the Appellant's 2003 Tax Returns, without any legal basis.

[116] In view of my findings on grounds one, two and three, I do not find it necessary to answer the matters raised in grounds four and five.

[117] In the result, I allow the appeal of the Appellant and set aside the judgment of the High Court dated 25 July 2018, and I also set aside the Amended Assessment dated 30 June 2016. I award costs against the Respondent in favour of the Appellant, in a sum of $3500.00 in this court, and in a sum of $2500.00 in the court below. These costs are to be paid within 28 days from the date of this judgment.

The Orders of the Court are:

1. The Appeal is allowed, and the judgment of the High Court dated 25 July 2018 is set aside.
2. The Amended Assessment dated 30 June 2016, is set aside.
3. The Respondent is ordered to pay to the Appellant costs in a sum of $3500.00 in this court, and in a sum of $2500.00 in the court below. These costs are to be paid within 28 days from the date of this judgment.

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Hon. Justice S. Lecamwasam
JUSTICE OF APPEAL

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Hon. Justice Almeida Guneratne
JUSTICE OF APPEAL

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Hon. Justice F. Jameel
JUSTICE OF APPEAL

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Hon. Justice S. Lecamwasam
JUSTICE OF APPEAL

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Hon. Justice Almeida Guneratne
JUSTICE OF APPEAL

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Hon. Justice Farzana Jameel
JUSTICE OF APPEAL