Kq (IV)

IN THE SUPREME COURT OF FIJI

Appellate Jurisdiction

Civil Appeal No. 5 of 1984

Between:

REDDY CONSTRUCTION COMPANY LIMITED Appellant

and

THE COMMISSIONER OF INLAND REVENUE Respondent

Mr. V. Kalyan for the Appellant
Mr. M.J. Scott for the Respondent

J U D G M E N T

This is an appeal against a judgment of the Court of Review dated 6th April, 1984 dismissing an appeal to that Court against an assessment of income tax by the respondent which, inter alia, rejected a claim that a sum of $50,000 lost by the appellant was a deduction chargeable against income tax.

The matter arose in the following fashion. In 1968 the tender and contract documents were prepared for the Government of Fiji by the Crown Agents for Overseas Governments and Administrations for the construction of a general hospital at Lautoka. One of the firms interested in obtaining the contract was Sir Lindsay Parkinson Company Limited (Lindsay Parkinson). The appellant is a local company engaged in the construction industry. Before Lindsay Parkinson submitted their tender for the works, they entered into an agreement with the appellant called a pre-bidding agreement. The main provisions of this agreement included the following:

(1) That Lindsay Parkinson would tender for the contract to build the hospital.

(2) That the appellant and Lindsay Parkinson would form a temporary association for the purpose of jointly preparing and submitting the tender for the works and (if the tender was successful) the parties to the agreement would execute the works as a joint venture, notwithstanding that the contract would be in the name of Lindsay Parkinson.

(3) The parties would place at the disposal of the joint venture all their technical skill and knowledge without any additional consideration.

(4) That the parties would share in the profit or loss of the venture in equal shares.

The above is a paraphrase of the terms mentioned and is not set out in the exact language used in the contract. There were other clauses which related to management and in particular Clause 6 which reads as follows :

> "6. Reddy's undertake to supply all the necessary Plant and Equipment in good workable condition as may be required to execute this Contract, other than particular units of Plant as set forth on Schedule B attached, at hire rates mutually agreed and upon which the Tender has been based.
>
> The Plant and Equipment shall be supplied in good workable condition and properly insured to the approval of both Parties. The Premiums for these Insurances shall be for the account of the Joint Venture. "

Each party agreed to supply fifty percent of the working capital required for the execution of the works, up to a maximum of $50,000 each. The agreement was to endure until all the financial agreements between the parties or towards third parties resulting from the agreement had been completely settled and liquidated.

Parkinson Reddy were awarded the contract by the Government. In January 1971 a new company was incorporated in Fiji called Parkinson Reddy Limited (Parkinson Reddy). Only two shares were issued - one was held by Lindsay Parkinson and the other by the appellant. Parkinson Reddy was incorporated in order that the terms of the existing agreement between the parties could be carried out by making use of a body with limited liability. It must be assumed that the parties considered this to be a satisfactory and convenient arrangement. Since the appellant had no contract with the Government of Fiji its obligations were to Lindsay Parkinson only. In June 1971 an agreement was made between Lindsay Parkinson and Parkinson Reddy under which the latter company became a sub-contractor under the main contract. It was to Parkinson Reddy that the $50,000 was paid by the appellant in pursuance of its undertaking to provide that sum to the joint venture as working capital. It was shown in the books of the appellant as a loan to Parkinson Reddy and in the books of Parkinson Reddy as a debt due on loan account to Reddy Construction.

The joint venture was not a success. The $50,000 was never repaid to the appellant, which purported to write off the debt in the trading profit and loss account for the year ending March 1982 and deduct this from profits made in that year. The respondent disallowed the deduction. Hence the present proceedings.

Section 19 of the Income Tax Act, Cap. 210 contains :

"19. In determining total income, no deductions shall be allowed in respect of -

(a) .....

(b) any disbursement or expense not being money wholly and exclusively laid out or expended for the purpose of the trade, business, profession, employment or vocation of the taxpayer;

.....

.....

(i) any expenditure or loss of capital nature. "

The main argument in this appeal is centred around the question as to whether or not the $50,000 loan by the appellant, which proved irrecoverable, was expended for the purpose of the appellant's business or was a loss of a capital nature.

The precise definition of a "loss of capital nature" has been debated in many jurisdictions and as has been said by Ogilvie Thompson J.A. in C.I.R. v. Cadec Engineering (Pty) Ltd. 1965 (2) S.A. 511 "alludes precise and comprehensive definition".

There is however a general agreement among the authorities that one has to look at the facts of each case and the purpose of the expenditure concerned in order to ascertain whether it is of a capital or a revenue account. (Silke South African Income Tax (10th Edn.) 319 and New Zealand Master Tax Guide 347).

I am satisfied the $50,000 was made available by way of loan to enable Parkinson Reddy, an associate company of the appellant, to carry out the works which it had contracted to perform on behalf of Lindsay Parkinson,

the main contractor. It was so treated by all the parties. If the venture had been profitable, no doubt the loan would have been repaid by Parkinson Reddy and the appellant would have suffered no loss. The agreement gave the appellant an additional advantage in that it provided for the hire by Parkinson Reddy of certain items of plant owned by the appellant which was to be paid off at the rates specified in the main contract.

The decision to set up Parkinson Reddy and make that company the recipient of the $50,000 by way of loan had the effect of bringing into existence a separate taxable entity. This raises the question as to whether the money was laid out or expended for the purposes of the business of the appellant.

The appellant is a company principally engaged in the building industry. It did not tender for the contract to construct the Lautoka Hospital. Instead, it made the arrangements outlined above. Although the $50,000 was transferred to Parkinson Reddy by equal payments of $25,000 each, that money was subsequently expended, not by the appellant, but, by Parkinson Reddy.

In Odhams Press v. Cook (1940) 3 All E.R. Viscount Caldecote, L.C. said at 17 :

> " These facts seem to me to be evidence upon which the special commissioner might reasonably arrive at the conclusion that the sum written off was not so written off wholly and exclusively for the trade or business of the appellants. No doubt it was better for the appellants that their subsidiary companies, and this one amongst them, should prosper, and not be weighed down with debts. The same would be equally true of any company holding shares in another company and having trading relations with it. It is tempting to treat what I have called the subsidiary company as if it were part and parcel of the appellants, but, as Sir Wilfrid Greene, M.R., points out, the two companies are separate taxable persons.

The trade or business of one company, even though it may affect very closely the trade or business of another, is not the same as that other's trade or business. Sched. D, Cases I and II, r.3(a), prohibits the deduction of

> 'any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade [of the person whose profits or gains are being computed].'

The appellants were computing their profits and gains, and it is their trade which is to be regarded. The special commissioner finds, on evidence of which there is abundance, that

> 'the sum written off was not so written off wholly and exclusively for the purposes of the trade or business of the appellants.'

That is enough to shut out the appellants' right to deduct the amount. "

The only difference in the present case is that Parkinson Reddy was not a subsidiary within the definition of section 127 of the Companies Act Cap. 216 (since repealed). But, it is clear from the words of Viscount Caldecote that the principle applies to any associated company with which a taxpayer had a trading relation.

In English Crown Spelter Co. Ltd. v. Baker 99 L.T.R. 353 the appellant taxpayer carried on the business of zinc smeltering. It formed a new company to augment the supply of blende and advanced to that company from time to time money by way of loan at interest to enable it to work certain mines. When the new company went into liquidation £38,000 was due by it to the appellants. It was held by the King's Bench Division that these advances were an investment in a separate concern and a capital expenditure and not money laid out exclusively for the purposes of trade and the appellants were not entitled to claim a deduction.

In C.I.R. v. Shipbuilders [1968] N.Z.L.R. 885 Turner J. said in the Court of Appeal at 905 :

> " All the reported cases in which one company has been allowed, as deductions, losses incurred in writing off advances made to another, be that other a subsidiary or not, fall without exception into two groups - those in which the original advances are shown to have been made by banker to customer in the course of an established mercantile banking or moneylending business, and those in which the transaction, though in form of a loan, has in substance been pre-payment for goods to be delivered. A payment for the purchase price of trading goods may be a trading expenditure; and a mere loan may be a trading expenditure if the lender is a banker or moneylender. Consequently in each of these two classes of case the expenditure may be a legitimate deduction. "

I take the view that these cases are conclusive against the appellant in this instance as there is nothing in the pre-bidding agreement which would suggest that its purpose was otherwise than to provide Parkinson Reddy with sufficient finance to enable it to carry out its obligations as sub-contractor to Lindsay Parkinson. The advantage which the appellant received under the clause which provided for the hire of plant and equipment was incidental. It cannot be said, taking the agreement as a whole, that this advantage was the main purpose of the arrangement. The business might have been secured by the appellant without the requirement that a large sum of money be invested to provide "working capital".

Having regard to the foregoing this appeal must be dismissed with costs subject to the following reservation.

I am extremely dissatisfied with the record that was prepared for the hearing of this appeal. The bulk of it consists of documents which were entirely irrelevant and included the entire memorandum and articles of association of the appellant company, of Sir Lindsay Parkinson and

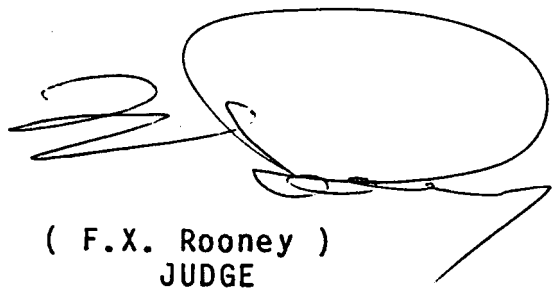
Company Limited and of Parkinson Reddy Limited.

Rule 5 of the Supreme Court (Income Tax Appeals) Rules reads :

> "5. The Chief Registrar shall cause a copy of the notes of evidence, and such other documents forming part of the record as he may deem necessary or expedient, to be made at the cost of the appellant for the use of the Court and shall, on the application and at the cost of any party to the appeal, furnish such party with a like copy or any part thereof. "

However, common sense dictates that nothing irrelevant or immaterial should be included in a record submitted to this Court. It is the function of the solicitors for both parties to ensure that there is excluded from the record all unnecessary documents. It is for the parties to assist the Chief Registrar in his task of compiling the record under the Rule.

This was not a proper record and the respondent's solicitor is as much at fault for what it contains as the solicitor for the appellant. In the taxation of costs, the Registrar is instructed to disallow the costs of perusing or copying those documents which he considers were unnecessarily included as part of the record.



(F.X. Rooney)
JUDGE

Suva,
8th March, 1985