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INCOME TAX APPEAL

Jamaica

No. 8 of 1973

In the Revenue Court - On 5th February, 1975

BETWEEN

CARIBBEAN SALES LIMITED - APPELLANT

AND

THE COMMISSIONER OF INCOME TAX - RESPONDENT

4/8/76

For the Appellant : Mr. Enos Grant.

For the Respondent : Mrs. A.C. Hudson-Phillips.

This is an appeal by the Appellant Company, Caribbean Sales Limited, against a decision of the Respondent made on the 25th June, 1973 in respect of the Years of Assessment 1965 and 1966.

There is no dispute as to the facts, which are briefly, as follows -

The Appellant Company was incorporated on the 24th December, 1964 and commenced trading as commission agents on, or about, the 2nd January, 1965. During 1965 it incurred bad debts amounting to approximately $695. It also incurred expenditure of approximately $720, by way of advances to commission agents, which proved unrecoverable. The Appellant sought to deduct both sums in the computation of its chargeable income for the relevant years of assessment, but these were disallowed by the Respondent; and the Appellant has appealed to this court to have that decision set aside, or varied.

Counsel on both sides agree that the issue raised in the case turns on the proper application of Sections 6 and 8 of the Income Tax Act, 1954, to the computation of tax liability during the initial years of a new business. Sections 6 and 8 were amended subsequently to the Year of Assessment with which this appeal is concerned and the case must therefore be considered in the light of these provisions as they stood at the relevant time.

Section 6 is a rather long section but the relevant portion

was contained in subsection (2) which provided as follows: -

> "(2) The statutory income of any person from any trade, profession or business for the year of assessment in which he commenced to carry on or exercuse such trade, profession or business and for the two following years of assessment (which years are in this subsection respectively referred to as "the first year","the second year", and "the third year") shall be ascertained in accordance with the following provisions -
>
> (a) for the first year the statutory income shall be the amount of the income for that year;
>
> (b) for the second year the statutory income shall, unless such notice as hereinafter mentioned is given, be the amount of income for the period of twelve months from the date of the commencement of the trade, profession or business;
>
> (c) for the third year the statutory income shall unless such notice as is hereinafter mentioned be given, be computed in accordance with the provisions of subsection (1) of this section;
>
> (d) the person carrying on or exercising the trade, profession or business shall be entitled on giving notice in writing to the Commissioner within two years after the end of the second year to require that the statutory income both for the second and the third year (but not for one or other only of those years) shall be the income of the respective years of assessment:
>
> Provided that he may, by notice in writing given to the Commissioner within twelve months after the end of the third year, revoke the notice, and in such case the statutory income both for the second year and the third year shall be computed as if the first notice had never been given;
>
> (e) where such a notice as aforesaid has been given or revoked, such additional assessment, or, on a claim being made for the purpose, such reductions of assessment or repayments of tax, shall be made as may be necessary to give effect to paragraph (d) of this subsection."

As will be seen from the foregoing, the subsection provided a special formula for the ascertainment of statutory income where a trade or business was being set up for the first time; and it was part of a package, the other half of which consisted of subsection 3, which also provided a special formula for the ascertainment of statutory income where a trade or business had ceased. Together

they were known as the "commencement and cessation provisions" and constituted a statutory variation to meet some of the problems which arose under the now abandoned previous year basis of assessment.

The relevant portions of section 8 as it stood at the material time, are as follows -

> "8. For the purpose of ascertaining the chargeable income of any person, there shall be deducted all disbursements and expenses wholly and exclusively incurred by such person in acquiring the income -
>
> (i) where the income arises from emoluments specified in paragraph (c) of section 5 of this Law, during the year of assessment; and
>
> (ii) where the income arises from any other source, during such time as is provided for in section 6 of this Law,
>
> and such disbursements and expenses may include -"

The section then proceeds to list, in separate paragraphs, various items of expenditure as falling within those opening words, including paragraph (d) with which this appeal is concerned. Paragraph (d) reads as follows -

> "(d) bad debts incurred in any trade, profession or business, proved to the satisfaction of the Commissioner to have become bad during the year immediately preceding the year of assessment, and doubtful debts to the extent that they are respectively estimated to the satisfaction of the Commissioner to have become bad during the said year notwithstanding that such bad or doubtful debts were due and payable prior to the commencement of the said year:
>
> Provided that all sums recovered during the said year on account of amounts previously written off or allowed in respect of bad or doubtful debts shall for the purposes of this Law be treated as receipts of the trade, profession or business for that year."

BAD DEBTS

It would seem from the wording of paragraph (d) that the Act as it then stood, did not allow a deduction of all bad debts incurred in a trade, but only such debts as had been "proved to the satisfaction of the Commissioner to have become bad during the year immediately preceding the year of assessment". Since therefore, the bad debts here in question were incurred in the Year of Assessment 1965, rather than the year which immediately

preceded it, the Appellant's case would on this point appear to be in ruins even before it can get off the ground. Nevertheless, counsel for the Appellant contended that on a proper interpretation of sections 6 and 8 aforesaid, the amount claimed was properly allowable in the computation of chargeable income of the Appellant for the Year of Assessment 1965.

The argument in support of that contention was put this way. Section 8 is to be read subject to section 6, in that the former section provides that the qualifying period for the expenditure, is to be - "during such time as is provided for in section 6". Consequently, all one need do is go to section 6 and see what is the appropriate period there provided for taxpayers in the circumstances of the Appellant. Basing himself, therefore, on that view of the matter, counsel submitted that although as a matter of historical record, the bad debts were not sustained during the year immediately preceding 1965, and could never have been since 1965 was its first year in business, the Appellant was nevertheless entitled to have them set off in 1965, because section 6(2) prescribed that the statutory income for year of assessment 1965 was deemed to be the income for that year, and not that of the preceding year, as would ordinarily have been the case with an established or continuing business.

This is a deceptively simple argument, since it is, to a certain extent, quite correct to say that the Appellant's assessment for 1965 must be approached in that manner, even though section 6 relates to "statutory income" while section 8 relates to "chargeable income", and the two concepts are not the same. Indeed when dealing with such disbursements as salaries, rents, and so on, the Respondent is obliged to compute the assessment on that basis. The difficulty in the instant case lies in the fact that paragraph (d) appears to be saying quite specifically, that the bad debts to which it relates are those incurred during the year <u>immediately</u>

preceding the year of charge, and so acceptance of the Appellant's contention would involve ignoring clear the words in the statute.

As I have had occasion to mention before, section 8 is something of an enigma in that some of its provisions are not readily reconcilable the one with the other. For example, although the opening words of the section repeat the well known common law concept of revenue expenditure being limited to - "disbursements and expenses wholly and exclusively incurred in acquiring the income" - the section, somewhat inexplicably, then goes on to provide that such disbursements and expenses may include certain items of "expenditure", which do not fall within the basic common law concept, embraced in those opening words. Oddly enough the very paragraph (d) relating to bad debts and with which this appeal is concerned, is a good example of such an anomaly. I say this because a bad debt is not, in the strict sense, an expense incurred in acquiring income, it is in fact a species of loss sustained after the income has been earned. This is necessarily so because, where the assessment is on an earnings basis as it is here, the income is earned at the very moment in time, that the trade debt is created.

The same is true of some of the other paragraphs contained in the section. See for example -

(1) Paragraph (n) which relates to Personal Allowances granted by section 12 and the allowance in respect of life insurance premiums granted by section 13.

(2) Paragraphs (i), (j), (k) (l) and (m) all of which relate either to superannuation or pensions' contributions

of one sort or another.

(3) Paragraph (p) which relates to annuities secured by deed of covenant in favour of theUniversity of the West Indies.

In none of the foregoing is there even the most tenuous of connections with - "a disbursement and expense wholly and exclusively incurred in acquiring income" - and yet the section states that they may be so treated.

Perhaps, however, the paragraph in the section most analagous to paragraph (d), is paragraph (h) - which allows a set off of trading losses incurred during the six years immediately preceding the year of assessment, to be treated as an expense wholly and exclusively incurred in acquiring the income of the year of assessment. Losses and bad debts incurred in previous years do not constitute expenses incurred <u>in acquiring</u> income for the year of assessment; although it may be true to say, taking one year with another over the life of a business, that they are part of the costs of running that business. On the other hand, it is settled law that the income of each year of assessment must be separately computed and it is not, therefore, ordinarily permissible to link the expenditure of one year with another. In such circumstances, it is not unreasonable to conclude that some of these paragraphs must have been included in the section, as deliberate statutory exceptions to the general common law rule embodied in its opening words. Conversely, paragraphs -

(a) interests,

(b) rents,

(c) repairs,

(f) rates and taxes, and

(g) property insurance,

all fall within the common law rule embodied in the "wholly and exclusive" doctrine, and would be deductible thereunder even though not separately listed in a paragraph . To that extent therefore, this latter group of paragraphs can be accepted as mere illustrations of that doctrine. The group of paragraphs mentioned earlier, however, cannot; and prima facie, must be regarded as special statutory exceptions thereto, which, presumably, were included in the section as a deliberate act of policy on the part of the legislature.

The position, therefore, is this. The section provides initially, that only expenditure which has been wholly and exclusively incurred in acquiring income is deductable in arriving at chargeable income for a year of assessment. It then goes on, however, to provide that such expenditure <u>may</u> include -

(a) items of expenditure will fall within the wholly and exclusive doctrine and which may be treated as mere examples of that concept, and

(b) other items of expenditure which do not fall within the doctrine and which, prima facie, would seem to be statutory exceptions thereto.

In such a situation I think that a more rational approach to interpreting this section would be to construe the word "may" in the phrase - "and such disbursements and expenses <u>may</u> include" - in a mandatory rather than permissive sense. If that is done, then one would simply ignore those paragraphs in the section which fall within its opening words, as being mere surplusage; since they,

having been already caught by the wholly and exclusive doctrine embodied therein, do not have to rely on a separate provision to give them efficacy. The remaining paragraphs would then constitute a series of express statutory exceptions to the common law concept of revenue expenditure, which by virtue of being specifically listed in the section, are to be deemed to fall within that c concept. By approaching the problem in that way one avoids some of the contradictions inherent in the wording of the section without destroying its legislative intent and effect; since on that basis all paragraphs delineated therein would continue to apply. Any other approach to the problem would, in my opinion, lead to undesirable results. For example, if one regarded all the paragraphs in the section as constituting mere illustrations of the wholly and exclusive doctrine, that would involve the undesirable proposition that Parliament had deliberately cited illustrations of that doctrine which were not known to the common law; a proposition which in the absence of clear direction no Court should readily accept. On the other hand by construing "may" as meaning "must", one avoids that dilemma by treating these paragraphs, not as illustrations of the rule, but as exceptions thereto.

For these reasons I have come to the conclusion, and I so hold, that paragraph (d) of section 8 is to be construed as a statutory exception to the concept of revenue expenditure contemplated by and embodied in the opening words of the section, which concept is that such expenditure is limited to - "disbursements and expenses wholly and exclusively incurred in acquiring the income". As an exception to the general rule paragraph (d) must be narrowly construed and it necessarily follows that the Appellant cannot succeed in its claim unless the case falls

clearly within the wording of that exception. Paragraph (d) states clearly that the only bad debts allowable thereunder are those sustained during they year immediately preceding the year of assessment. Since, therefore, the bad debts here in question are not within that description it must necessarily follow that it cannot be allowed as a deduction for the Year of Assessment 1965. I may add, however, that they would be allowable in the succeeding year of assessment. It is therefore my opinion, and I so hold, that the Respondent's decision on this point in the case was correct and in accordance with the statute, and is therefore to be confirmed.

UNRECOVERED ADVANCES

I turn now to a consideration of the second question raised in this appeal namely, whether the unrecovered advances made by the Appellant to its agents, are trading expenses. The circumstances surrounding the making of these payments are set out at paragraph 2 of Exhibit 3, which reads as follows -

> "The unrecovered advances on account of commission, while quite properly so described, have in effect become payments in leiu of commission. It is common practice when recruiting and training salesmen who will be remunerated wholly or partly by commission, to make "advances" to them during periods when, due to their own inexperience or the lack of "leads" i.e. prospective customers, or other causes, they are unable to make sufficient sales to provide an adequate commission. It is the usual understanding in these cases that such advances are recoverable only from future commissions and that where the salesman leaves the company before the "advance" has been recovered in this way, it will automatically be written off and no attempts made to collect it.
>
> As the writing-off of the amounts referred to was a condition of the salesman's contract they are an allowable deduction for the company, and of course an assessable emolument of the recipient."

Counsel for the Respondent submitted that since the expenditure incurred in respect of these advances did not fall within any of the paragraphs delineated in section 8, it could only be allowed

if it qualified as "a disbursement or expense wholly and exclusively incurred in acquiring income". It was submitted that it did not so qualify because it failed to meet the test of exclusivity laid down by the section, in that the payment was not remuneration for duties performed by the agents, but were in fact payments for services which might be rendered by them in the future, and could not therefore, constitute an expense in acquiring income since no income was in fact earned as a result of the expenditure. It was, counsel submitted, because the agents could not earn any income for the Appellant as would entitle them to the commission why it became necessary to make the advance in the first place. In support of this contention counsel cited the case of Roebank v. C.I.R. 13 T.C. 864 - where commissions advanced by a company to its managing director and not repaid by him were held not to constitute expenditure wholly and eclusively incurred by the company for the purposes of its trade.

Counsel for the Appellant, however, submitted that Roebank's case was distinguishable on its facts, because in the instant case the Appellant's main contention was that the making of the advances was an established practice of the commission agency business carried on by the Appellant, and was a necessary and essential ingredient of its capacity to earn profits.

If I have correctly stated the arguments of counsel for the Respondent on this point, then it would seem that the main contention is that although the making of advances to individual agents may be an essential aspect of the Appellant's business, any portion of the total advances made which proved unrecoverable must be disallowed on the basis that such portion did not earn any income for the Appellant in the relevant year. But is that necessarily so?

In Vallambrosa Rubber Company Limited v. Farmer 5 T.C. 529

expenditure incurred by a company on the cultivation of young rubber trees which produced no income in the relevant year due to their immaturity, was nevertheless, allowed as expenditure wholly and exclusively incurred for the purposes of the company's trade.

The headnote to that case reads -

> "A Rubber Company had an estate of which in the year under review one-seventh only produced rubber, the other six-sevenths being in process of cultivation for the production of rubber. (Rubber trees do not yield rubber until they are about six years old.) Expenditure for superintendence, weeding etc., was incurred by the company in respect of the whole estate.
>
> Held, that in arriving at their profits the company was entitled to deduct the expenditure for superintendence, weeding etc., on the whole estate and not one-seventh of such exepnditure only."

The Vallambrosa case is authority for saying, therefore, that expenditure may in certain circumstances nevertheless be deductible as a trading expense even though it produces no income in the particular year.

In all cases of this nature the outcome depends, as it must, on the particular facts. In the instant case the Appellant contends that it is the practice in the commission agency business to remunerate agents in the manner described, during the earlier years of the business until they develop the necessary leads and contracts. That contention was never challenged by the Respondent and in the absence of any evidence to the contrary, must be accepted. It may be that persons in that line of business find the practice a useful method of recruiting personnel who might otherwise be reluctant to offer their services in what is essentially a highly competitive and speculative business. The amount spent on these advances was for the purpose of enabling the Appellant to earn profits in its business, and it seems to me that the fact that some of the amounts disbursed did, and the rest did not, produce income in the

particular year is analogous to the situation that existed in the Vallambrosa case, where expenditure incurred on all the trees was allowed even though some of those trees, by reason of the immaturity did not produce income in the relevant year. However, since the Valambrosa case, was never canvassed before me I do not intend to pursue the analogy.

Turning therefore, to the case which was canvassed, namely Roebank's, I find that there is a passage in the judgment of the Lord President which suggests that the Court there was not attempting to lay down a rule which was to be universally applied to all commission advances. The passage is at page 875-876 of the report and reads as follows -

> "It may be the case - I rather think it is - that payments in advance to account of commissions which cannot be ascertained until the end of the year are sometimes made in the course of the year by persons whose business knowledge and experience are beyond doubt; and it is not my intention to lay down any universally applicable proposition to the effect that losses arising from such payments in advance can in no circumstances form a proper charge against a trading account for purposes of Income Tax. But it seems to be impossible to take any view of the transactions on the Company's commission account during the year 1923 which would show them to have played a part in, or to have been conducive to, the making of profit in the Company's trade. If it were legitimate for us to make an inference of fact from the facts stated in the Case, I should be disposed to think that the managing director was using the Company as his banker. But it is, I think, enough to say that the financial indulgence shown to him by the company went far beyond anything which could be jusitfied by, or could be consistent with, any trading interest of the Company."

That passage seems to me to suggest -

(1) that the court there was not saying that unrecovered advances could never form a proper charge in a trading account; and

(2) that one test as to whether it was a proper charge was to look to see whether the amount disbursed "played a part in" or was "conducive" to the making of profits.

Looking therefore, at the circumstances in the instant case I think that Roebank's case is distinguishable on its facts.

There is no suggestion in the instant case that the former agents employed by the Appellant were simply using it as their bank. The payments were made to them as a necessary and essential ingredient for enabling the Appellant to earn profits from its business. They were not loans in the ordinarily accepted sense, but, if I may respectfully borrow from the language of the Lord President, were disbursements which "played a part in" or were "conducive" to the making of profits by the Appellant. They were not made because of any special personal relationship between the Appellant and its agents, but simply to enable the former to earn income in the business upon which it had embarked. As such they constitute, in my judgment, a disbursement and expense wholly and exclusively incurred by the Appellnat in acquiring its income for the years of assessment in question.

To summarize, therefore, it is my opinion, and I so hold, that -

(1) paragraph (d) of section 8 is an exception to the general rule contemplated by and embodied in the opening words of that section as to the essential ingredients of revenue expenditure. As such it is to be strictly construed and the Appellant will not, therefore, be entitled to the deduction claimed unless the case can be brought within the specific wording of the paragraph. The Appellant has been unable to do so and it therefore follows that the Respondent was correct in rejecting its claim;

(2) the unrecovered advances fall within the concept of revenue expenditure embraced by the section, in that, they constitute disbursements and expenses wholly and

exclusively incurred by the Appellant in acquiring its income for the relevant years of assessment. The Respondent was, therefore, in error in disallowing this portion of the Appellant's claim.

It is the judgment of this Court, therefore, that the decisions of the Respondent herein are to be varied in accordance with the foregoing, and the Appellant is to have the costs of, and incident to, this appeal.

(D. W. Marsh)
Puisne Judge - Revenue Court
4th March, 1976