THE SUPREME COURT OF JUDICATURE OF JAMAICA

IN THE REVENUE COURT

REVENUE APPEAL NO. 1 OF 2005

BETWEEN	CIGARETTE COMPANY OF JAMAICA LIMITED	APPELLANT
AND	THE COMMISSIONER OF TAXPAYER AUDIT AND ASSESSMENT	RESPONDENT

Heard: May 22, 24, 25, 26, 29, 2006; and October 31, 2007

Richard Mahfood Q.C., Dr. Lloyd Barnett and Mrs. Michele Champagnie instructed by Mr. Noel Levy and Miss Tamara Green of Myers Fletcher & Gordon for Appellant. B. St. Michael Hylton Q.C., Solicitor General, Ms. Nicole Lambert and Ms. Thalia Francis instructed by the Director of State Proceedings for the Respondent

CORAM: ANDERSON J.

This is an appeal by the taxpayer company, Cigarette Company of Jamaica Limited ("CCJ" or "the Appellant"), against the decision initially made by the Commissioner Taxpayer Audit and Assessment ("the Respondent") issued on the 29th December, 2003 and subsequently confirmed by the Commissioner of Taxpayer Appeals on the 23rd day of November, 2004, whereby it was ordered that the decision of the Respondent to treat the transfer of funds from the Claimant to its parent company Carreras Group Limited for the years of assessment 1997 to 2002 as distributions liable to income tax, be confirmed.

The Appellant sought an order in the following terms: "The Decision of the Commissioner, Taxpayer Appeals be set aside by the Revenue Court under section 76 Income Tax Act with costs to the Claimant in these proceedings and below on the grounds that the Commissioner erred in law and on the facts". The Appellant set out twelve Grounds upon which that order was sought which covered the substantive decision as well as the decision to impose penalties on

the sum assessed at 50% and these are set out in the Appellant's Third Amended Notice of Appeal and for completeness I set these out below in full.

1. The Notices of Assessment issued under Section 72 Income Tax Act are null and void for failure to state "the basis on which the assessment is made" in accordance with the provisions of Section 75(3) Income Tax Act. The Notice of Assessment is null and void since the Table of Distributions established by Section 34(1) Income Tax Act prescribes in separate paragraphs the acts which alone may be treated as distributions for the purposes of the Act and the notice failed to identify the paragraph in the Table which is applicable.

2. The decision of the Commissioner of Taxpayer Audit and Assessment to confirm the assessment upon review of the objection is not sustainable in law, since she failed to identify the paragraph in the Table of Distributions which she believes is applicable.

3. There is no paragraph in the Table of Distribution which would permit the assessment to be treated as a distribution for the purposes of the Income Tax Act.

4. The finding of facts by the Commissioner, Taxpayer Appeals, that the Commissioner of Taxpayer Audit and Assessment correctly concluded that the transfers were not genuine loans but taxable distributions is unreasonable, not supported by the evidence and contrary to the evidence and/or is contrary to the provisions of Section 16 (1) Income Tax Act which only permits the Commissioner of Taxpayer Audit and Assessment to disregard any transaction or disposition which she may find is artificial. The Commissioner, Taxpayer Appeals erred in law in finding that the Commissioner of Taxpayer Audit and Assessment could treat or re-characterize the transfers as "taxable distributions".
5. In coming to his conclusion on the facts, the Commissioner, Taxpayer Appeals, ignored relevant facts.

6. The Commissioner, Taxpayer Appeals, failed to apply the legal principle authorized by the legal authorities that the central feature of a loan transaction is that the parties must intend that the whole of the moneys should be repaid. The central issue here is the factual one of whether at the time of advances in question there was a definite intent to repay the advances. This intention was established by the evidence of the subjective intent of the parties as well as the evidence of the objective factors surrounding the loan transactions.

7. The only proper conclusion on the evidence of the intent of the parties and the objective factors is that the loans were genuine loans.

8. The Commissioner, Taxpayer Appeals erred in law and on the facts in relying on the provisions of Section 16(1) Income Tax Act which deal with "artificial or fictitious" transactions. His reliance on Section 16(1) Income Tax Act is clearly misconceived having regard to the facts established by the Claimant.

9. The Commissioner, Taxpayer Appeals erred in relying on Section 16(1) Income Tax Act, since:

   (i) genuine loans made for a bona fide commercial purpose cannot be treated as "artificial or fictitious",

   (ii) Loans between a subsidiary and its parent resident in Jamaica are specifically exempt from income tax by Section 35(1) Income Tax Act.

10. The unchallenged evidence presented by the established the following facts:

   (i) At the time of the advances in question, there was a definite intention to repay such advances. Both Cigarette Company of Jamaica Limited and Carreras Group Limited intended that the whole of the moneys advances would be repaid.

   (ii) The Directors and treasury management of Carreras Group Limited have, over the years, been very careful to maintain its investments portfolio in high quality investments and those of efficient and expeditious marketability of a value at all times capable of repayment of the loans to Cigarette Company of Jamaica Limited. The annual audited financial statements of Carreras Group Limited provide clear evidence of its ability to repay the loans whenever repayment was requested by Cigarette Company of Jamaica Limited.

   (iii) The companies have always caused all loans to be accurately disclosed and published and published in the respective company's financial statements and in the Annual Report sent to shareholders.

   (iv) Had the loans assessed as being distributions made by Cigarette Company of Jamaica Limited been in fact distributions, there would have been a serious breach of the Companies Act since such distributions would have resulted in a return of capital to shareholders.

(v) Further, "distributions" would not have been for the benefit of all shareholders of Cigarette Company of Jamaica Limited but only for the majority shareholder Carreras Group Limited, which would clearly be a fraud on the minority.

(vi) Dividends were appropriately proposed and declared and paid for years ended March 31, 1997 – 2002. In addition to the appropriation for dividends, Cigarette Company of Jamaica Limited made distributions by way of the issue of bonus shares.

(vii) The repayment of the loans was agreed by the Board as part of a proposed reorganization before the Revenue Authorities suggested that they were distributions. The loans were actually repaid on February 27th 2004.

(viii) Carreras Group Limited adopted the best business and commercial practices followed by its overseas parent which included the provision of a central treasury function for its operating subsidiaries. This practice is commercially advantageous and essential for the proper management of the cash flows of its operating subsidiaries.

(ix) Given that the cash resources of the group and their utilization would be considered by the Board at the time of reviewing and approving the annual budget, it would not be the norm for specific Board approval to be obtained for any movement in inter-company loans as a result of the transfer of surplus funds. Under these circumstances, the inter-company loans would not have a fixed maturity date and would not necessarily be supported by any collateral.

(x) The Carreras Group Limited practice in relation to the movement of funds serves an important business purpose and is commercially advantageous.

(xi) Inter-company loans made between group companies resident in Jamaica were exempted from the anti-avoidance provision (Section 35 Income Tax Act) because they were never regarded as tax avoidance activities but rather the normal commercial operation of group of companies.

(xii) Although, as the Commissioner of Taxpayer Audit and Assessment stated in her Reasons, there was no repayment schedule, the legal position is that the loans were repayable at once whenever required.

(xiii) In view of the fact that the 1977 agreement provided for interest free loans from Cigarette Company of Jamaica Limited and Carreras Group Limited, and that Cigarette Company of Jamaica profits were primarily generated from the use of two major trademarks controlled by Carreras Group Limited, in the interest of fairness, Carreras Group Limited opted not to charge Cigarette Company of Jamaica royalties for the use of the trademarks, **and so the practice was not to charge interest on the loans and not to charge fees for the use of the trademarks.**

11. The commissioner, Taxpayer Appeals, erred in concluding that the Commissioner of Taxpayer Audit and Assessment acted reasonably in the imposition of the maximum penalty since the facts are that-

(i) The audited financial statements have always been filed with each company's annual income tax return to the tax authorities and at all times full disclosure has been made to the tax authorities and in addition both Cigarette Company of Jamaica Limited and Carreras Group Limited have undergone audits by the Revenue Board Department in 2001 covering the period January 1999 to December 2000 in the case of Carreras Group Limited and in 2000 covering the period January 1998 to December 1999 in the case of Cigarette Company of Jamaica Limited.

(ii) The motive and purpose of the loan transactions was not the avoidance of tax and tax was not avoided.

(iii) The levying of maximum penalties in the circumstances is excessive and grossly punitive. The Commissioner of Taxpayer Audit and Assessment ought in levying any penalty to have taken account of the tax which Carreras Group Limited would not have had to pay had Cigarette Company of Jamaica Limited declared dividends to Carreras Group Limited annually and these were passed on to its shareholders.

12. The levying or imposition of the said penalties on the Appellant by the Commissioner of Taxpayer Audit and Assessment on the basis that the Appellant had effected artificial or fictitious transactions in order to avoid the incidence of income tax is unconstitutional, unlawful and void since the vesting of power to impose such penalties in the commissioner is a usurpation of the judicial power and therefore infringes the principle of separation of powers and the fundamental rights of the Appellant to the protection of law and to be tried and

punished only by a duly constituted court which rights are guaranteed by sections 13 and 20 of the Constitution of Jamaica. Further The Commissioner did not act fairly and in accordance with natural justice in that she proceeded to impose the penalty without any proper notification thereof to the Appellant or opportunity being offered for it to make representation in respect thereof.

The Respondent answered the Appellant's Notice and Grounds of Appeal with its Statement of Case and again for completeness, I set out in full, the reasons given by the Respondent.

> The Respondent will contend at the hearing of this Appeal that the aforesaid decision was validly made and should be confirmed by this Honourable Court for the following reasons, among others:

REASONS

(A) The Respondent, in the exercise of her powers under section 16 of the Income Tax Act, can examine transactions and the circumstances in which they were made and carried out, and determine whether they are artificial or fictitious. The Respondent examined all the circumstances surrounding the transfers of funds between the companies and formed the opinion that these circumstances did not indicate the creation or existence of a debtor/creditor relationship. The failure to repay any of the amounts transferred for more than ten (10) years, the absence of any terms and conditions of repayment, and the absence of any security on the transfer of such large sums of money were, in her opinion, inconsistent with prudent or usual commercial practice and suggested that these transfers were "artificial" loans.

(B) By virtue of section 16 of the Income Tax Act, the Respondent has the power to disregard any transaction or disposition, which in her opinion is not what it is said to be, and the effect of which would be the reduction of a person's tax liability. She also has the power to assess any person to income tax in relation to any such artificial transaction.

(C) Each Notice of Assessment, along with the attached Explanation of Items disclosed a sufficient basis on which each assessment was made.

(D) Had the amounts been distributed to Carreras, they would have been subject to income tax. The Respondent was of the view that these amounts were transferred for the exclusive

benefit of the parent company as "loans" in order to avoid the incidence of income tax. The transfers of funds from the Appellant to Carreras were, therefore, treated as taxable distribution made by the subsidiary to its parent company.

(E) Although the Appellant maintains that the amounts are repayable on demand, an examination of the relevant financial statements of Carreras does not demonstrate an ability to repay the total amount transferred on demand. At the end of most financial years, the total amount of funds transferred exceeded the net current assets of Carreras.

(F) The Appellant has failed to prove to the satisfaction of the Respondent that the loans were genuine. The Agreement 1977 relied on by the Appellant merely permitted Carreras to borrow from the Appellant amounts required from time to time, on condition that Carreras guarantees the repayment of such "loans" at such time and in such manner as the companies may mutually determine. There is no evidence of any such guarantee, neither has Carreras satisfactorily demonstrated that the "loans" were required by it.

(G) The Respondent is obliged by section 41(2)(b) of the Act to increase the tax payable by a person required to deduct tax on the payment by him of any sum and who has failed to pay or account for that tax. Her discretion relates only to the rate by which the said tax should be increased. The exercise of her discretion in making this assessment and not be described as unfair or unreasonable.

(H) The increase in tax in accordance with section 41(2) (b) of the Act is not unconstitutional, unlawful or void, or a usurpation of the judicial power.

(I) In arriving at the decision that the Appellant had transferred these funds for the exclusive benefit of its parent company as "loans" in order to avoid the incidence of tax, the Respondent applied established rules and principles, considered all relevant matters, did not consider irrelevant matters, and did not err in fact or in law in arriving at her decision.

(J) The Commissioner of Taxpayer Appeals arrived at the decision being appealed from by applying established rules and principles, by considering all relevant matters, and by ignoring irrelevant matters. In so doing, she did not err in fact or in law in arriving at the said decision.

Before embarking upon the examination of the issues raised by this case, as well as the submissions by the parties in relation to those issues, it will be necessary to set out the facts which give rise to this appeal. There is considerable agreement upon the factual substratum on which this appeal stands, but limited agreement upon the implications of the facts.

The Appellant is a private company and is a subsidiary of Carreras Group Limited (Carreras). At the relevant time, the principal activities of the Appellant were the manufacturing and marketing of cigarettes. Carreras owns 99.8% of the shares in the Appellant. The Appellant had consistently made transfers of funds to Carreras since 1978. At first, the annual amounts transferred were relatively small compared to the actual amount of the Appellant's annual profits. The annual amount of funds transferred increased dramatically in 1989 and continued to grow substantially until they began to exceed annual profits of the Appellant in 1990. Of the total amount of $10.5 billion calculated to have been transferred, approximately $10 billion was transferred between 1990 and March 2004.

From 1999 until it was placed in voluntary liquidation in March 2004, the Appellant made annual profits in excess of $1 billion. However, during that period, the Appellant did not declare an annual dividend in excess of $4.6 million. There was, apparently, no loan agreement in place in relation to the fund transfers between the companies and there were no express terms or conditions for the repayment of these sums of money and the "loans" were unsecured. The funds were transferred monthly by way of authorization letters from the Appellant's management to their bankers requesting the transfer of funds from a stated bank account of the Appellant, directly to a stated bank account of Carreras. There does not appear to be any other documentation in relation to these transfers.

The relevant Minutes of the Directors' Board Meetings of the Appellant give no indication that there were any discussions about the transfer of funds or approval

given for the transfer of funds or grant of loans. The relevant financial statements of Carreras and the Appellant merely reflected the transactions as amounts due to subsidiary and amounts due from parent company, respectively.

By way of letter dated February 18, 2003, Carreras' external auditors wrote to the Director General of the Tax Administration informing him that Carreras was considering reorganization of the Group structure. It was explained that Carreras intended to voluntarily liquidate most of its subsidiaries, including the Appellant, and to take over the business of manufacturing and marketing cigarettes. They stated that Carreras was seeking clearance for some of the proposed transactions and advice on the tax status of all the proposed transactions.

On April 1, 2003, the Respondent raised an assessment in the sum of $5.7 billion in respect of the transfer of funds for the years of assessment 1997 to 2002, on the basis that these transfers were not genuine loans, but that they were "distributions", liable to income tax. The assessment was made up of tax in the amount of $2.17 billion, and penalty of $3.54 billion as at 28th March 2003.

The Appellant objected to the assessment on the grounds that there was no basis in fact or law to treat the transfers as distributions; that section 34 of the Income Tax Act contains an exhaustive list of transactions that can be treated as distributions by a company and that the Respondent had not classified the transfers as any of those transactions. The Appellant also objected to the imposition of the maximum penalty under section 41(2)(b) of the Income Tax Act.

After considering the objection, the Respondent confirmed the assessment on December 29, 2003. Thereafter, on January 1, 2004, Carreras took over the operations of the Appellant in accordance with the planned voluntary liquidation of the group's subsidiaries. The Appellant has indicated that as of January 1, 2004, Carreras was charged interest on the purported loans until the date of repayment.

The Appellant appealed to the Commissioner of Taxpayer Appeals by way of Notice of Appeal dated January 30, 2004. In its appeal, it relied on the grounds of objection raised before the Respondent. The Appellant submitted several statutory Declarations which it relied on at the hearing of the appeal before the Commissioner of Tax Appeals. In the meantime, on the 27th February 2004, Carreras repaid to the Appellant all the sums transferred since 1978. The amount repaid was $10.58 billion.

On the 15th of March 2004 a liquidator was appointed for the Appellant. The Appellant began distributing its assets on winding up and the respondent has been informed that the Appellant has paid out approximately $4.9 billion to Carreras by way of partial capital distribution. On November 23, 2004 the Commissioner of Taxpayer Appeals made a decision confirming the earlier decision of the Respondent. The Commissioner found that the Respondent had considered all the surrounding circumstances of the transfer of funds between the Appellant and its parent company and had correctly concluded that the transfers were not genuine loans, but taxable distributions. The Commissioner also found that in light of the circumstances, the Respondent had acted reasonably in the imposition of the penalty.

Before the Commissioner of Taxpayer Appeals and again before this Court, Mr. Mahfood has argued that the essence of the matter to be decided is whether the transfers were genuine "loans" as contended for by the Appellant, or not. He submitted with considerable force and logic that:

> "The basis of the Commissioner's assessment is that the loans are not genuine. That is the one basis; there is no other basis and therefore if you conclude on the basis of the assessment of the evidence that the loans are genuine, that is, as I have said, an end of the assessment and the Appeal must be allowed in my respectful submission".

Although the Appellant's Third Amended Notice of Appeal set out some twelve (12) grounds, (with several sub grounds)[1] the actual submissions did not follow the specific terms set out in that notice. Rather, counsel for the Appellant appeared firstly, to seek to impugn the procedural legitimacy of the assessment. (See Grounds 1 and 2). Secondly, it was argued that, in any event, since the transfers were in fact "loans", the Respondent had no basis upon which to treat them as distributions and so, no question of assessment could arise. (Grounds, 3 and 4 to 10) Thirdly, the Appellant purports to attack the validity, and indeed, the constitutionality of the Commissioner's right to impose the maximum penalty on the sum assessed. (Grounds 11 and 12) I agree with the summation of Counsel for the Respondent that the Appellant's grounds may be conveniently treated as falling within these three broad heads of argument and I shall examine the submissions within that context.

The procedural legitimacy/validity of the Assessment

The Appellant posits a number of bases for the proposition that the assessment is bad. It was submitted that an assessment pursuant to section 72 of the Income Tax Act is null and void if it fails to state the basis upon which it was made. It was contended further that a notice of assessment that is void cannot be amended or later justified by a subsequent explanation The Appellant's submissions cite section 75(3) of the Act, sub-sections (2) and (3) of which are set out below. In analyzing these provisions, counsel for the Appellant submits that there is a difference between those provisions which are mandatory in nature, and those which are merely "directory".

75. (1)

(2) No assessment charge or other proceedings purporting to be made in accordance with the provisions of this Act shall be quashed, or deemed to be void or voidable, for want of form, or be affected by reason of a mistake, defect or omission therein, if the same is in substance and effect in conformity with or according to the intent and meaning of this Act, and if

[1] See grounds set out above

the person charged or intended to be charged or affected thereby is designated therein according to common intent and understanding.
(3) An assessment or the duty charged thereon shall not be impeached or affected-

(a) by reason of a mistake therein as to -

(i) the name or surname of a person liable; or

(ii) the description of any income; or

(iii) the amount of the tax charged; or

(b) by reason of any variance between the notice and the assessment:

Provided that in cases of assessment the notice thereof shall be duly served on the person intended to be charged and such notice *shall state the basis* on which the assessment is made.

Appellant submits that when one looks at section 75(3) of the Act, certain requirements are formal and insufficient to invalidate the assessment as those requirements are merely directory in nature. It is argued, on the other hand, that the proviso to the subsection to the effect that "such notice shall state the basis on which the assessment is made", is a "mandatory requirement", (to be distinguished from other requirements which are formal and may be overlooked) and the failure to comply with which, invalidates the assessment. In the words of the Appellant's submission:

> The statute actually identifies which requirements are mandatory and which are directory. Thus, S.75 (3)(a) provides that a mistake as to name, description etc., or a variance between the notice and the assessment shall not of itself invalidate the assessment (`shall not be impeached or affected') - i.e. those requirements are merely directory. But the same does not apply to the requirements (a) that it be served on the person intended to be charged and (b) that the notice shall state the basis of the Assessment. These requirements, by contrast, must be mandatory.

Appellant's submissions cite **Wade: Administrative Law (8th edn) pp. 306-307; 227-234** in support of its claimed distinction.

It is not immediately clear that parliament intended the assessment to be null and void if no basis was stated and, indeed, as Respondent's attorneys-at-law say, no direct case law authority is given for the proposition in the first limb of the submission. As Respondent's counsel points out, the learned authors of Wade, the authority cited by the Appellant, make the point that the court would not invalidate for irregularities which are "merely technical" or which "lead to no unjust consequences."[2] In further support of the submission that a failure to state a basis makes the assessment null and void, Appellant refers to **DAWSON LIMITED v BONNIN**[3]. In that case, which was not a tax case, Viscount Cave said that "the basis of a thing is that on which it stands and on which it falls". With respect, I do not see how that statement advances the submission or has any necessary application in a tax case.

Counsel for the Respondent counters that Appellant seems to be of the view that the term "basis of the assessment" means that the Respondent must state "the relevant section of the Act" under which the assessment is purportedly made. It was submitted that if this was intended, the statute could have said so explicitly. It did not. Further, it was submitted that each Notice of Assessment, along with the attached "Explanation of Items", sufficiently disclosed the "basis" on which each assessment was made. Moreover, it was posited that, in any event, there was indeed evidence contained in the evidence of George Ashenheim that the Appellant was never in doubt as to the "basis" of the assessment. This is clearly indicated in the statutory declaration of Mr. George Ashenheim, the Chairman of the Appellant at the relevant time. In that declaration, Mr. Ashenheim at paragraphs 36 to 38, referred to a letter from the Commissioner dated March 21, 2003. He said:

> "I was therefore quite astonished to see the contents of a letter from the Commissioner dated March 21, 2003..... addressed to KPMG stating that the loans were assessable as distributions since it was clearly contemplated and so

[2] Wade: Administrative Law; 8th Edition at page
[3] (1922) 2 A.C. 313

> indicated to the Revenue Authorities, that the loans would be repaid by CGL as part of the reorganization".

In the two succeeding paragraphs Mr. Ashenheim's statutory declaration continued:

> The repayment of the loans was agreed by the Board as part of the proposed reorganization before the Revenue Authorities "discovered" and "suggested" that they were distributions. The loans were actually repaid on February 27th 2004.
> The Commissioner's letter stated as follows at paragraph 2:
>
> > Tax Implication
> > The tax Implication relating to amounts purportedly shown as loans from related companies to Carreras Group Limited are being examined as, in our opinion, these amounts are not bona fide loans and as such will be treated as distributions subject to withholding tax. Assessments will be raised and issued to recover tax.

In a recent case before this Court, **Dennis Murray v Commissioner of Taxpayer Appeals**[4], counsel for that appellant made a similar submission to that made by the Appellant here, to the effect that the failure of the Respondent to "state the basis of the assessment" meant that the assessment was "flawed". In that case counsel cited as authority for that proposition, the Privy Council case from Guyana, **Argosy Co. Ltd. (In Voluntary Liquidation) v C.I.R. [1970] 15 W.I.R. 502** as well as the unreported Jamaican case **Karl Evans Brown v Commissioner of Income Tax [1989] Revenue Court Appeal No: 43/86.**

In **Murray**, appellant's counsel submitted that "an examination of the evidence presented provides no information whatsoever as to the basis on which the Commissioner formed the view that the Appellant was liable to pay additional/estimated tax". It is clear that there, counsel did not conceive of "basis" as being the citing of a particular subsection, but rather as a function of the available evidence being adequate to inform the appellant of what the

[4] RCA No: 4 of 2006

Commissioner was using to ground his assessment. And as Respondent's counsel points out in the instant case, the evidence herein does confirm that the Respondent had provided explanations as evidenced by Mr. Ashenheim's affidavit referred to above.

Respondent's counsel further suggests that the decision of our own Court of Appeal in **Collector of Taxes v Winston Lincoln**[5] also provides some guidance as to what is required of the Commissioner when supplying "the basis" on which an assessment is made. It was submitted that the Court in that case[6], did not suggest that the Commissioner needed to identify the applicable sub-section of the Act, or that a failure to do so would make the assessment "null and void". On the contrary, as Rowe P. opined, **"the Commissioner is obliged ... to state at the minimum the sources of income e.g. – trade, profession, business, real property..."**. In any event, as counsel for the respondent in **Murray** (see above) stated, the relevant section of the Act has been amended after the **Winston Lincoln** case and the amendment appears to lower the requirements now applicable, which are placed on the Revenue. At the time of the **Lincoln** decision, the provision required that the assessment provide notice "*in substance and effect*", of the particulars on which the assessment was made. There was, it would seem, a need for a more fulsome explanation as to the source of the income. That requirement has now been changed in the statute to say the notices must *state the basis of the assessment*. As I said in Murray on this point, "I do not believe that the expression "the basis of the assessment" is to be given some special technical meaning".

Similarly, as I said in Murray:

> I believe that the protestations in these submissions are profoundly misconceived and an examination of the very authorities cited will indicate that all that is a necessary is a reasonable or "rational" basis for believing

[5] RMCA 2/86 dated 5/2/88
[6] Winston Lincoln

> that the taxpayer has a tax liability. Thus for example, if the taxpayer had received taxable income from his employment in the previous year and remained in that employment, it would not be unreasonable to believe that a liability will arise in the current year, at least assuming no adjustment of the threshold.

The submissions on the issue of "basis" in the instant case are, in my view, in no better position than those to which I directed my aforesaid comments in **Murray**. It seems that all that is being said by the Commissioner is:
"You have made some transfers. You have characterized them as loans. I do not accept that they are loans and I say they fall within the statutory definition of distributions. I am going to raise an assessment on the basis of the foregoing"

In any case, counsel for the Revenue asks that the Court pay due attention to section 75(2) of the Act which, it is suggested, validates the notice of assessment and which provides as follows:

> "No assessment charge or other proceedings purporting to be made in accordance with the provisions of this Act shall be quashed, or deemed to be void or voidable for want of form, or be affected by reason of a mistake defect or omission therein if the same is in substance and effect in conformity with or according to the intent and meaning of this Act and if the person charged or affected thereby is designated therein according to common intent and understanding".

It was submitted that that "the assessments in the instant case conform in substance and effect with the intention of the Income Tax Act in so far as they indicate who the taxpayer is and that the taxpayer is being charged income tax in respect of payments it made, on the basis that they should be treated as distributions". I believe that on this limb of the appeal, the Appellant has failed to establish that the Commissioner had acted contrary to her powers under the Income Tax Act.

But this submission of the Appellant also goes on to make another proposition: that if the initial assessment is bad it *cannot* be corrected. In **GRUNWICK PROCESSING LABORATORIES LIMITED v CUSTOMS AND EXCISE**

COMMISSIONERS[7] cited by the Respondent, the taxpayer sought to argue that an assessment was a nullity because the Commissioners of Customs and Excise had made an assessment, but failed to notify the taxpayer in accordance with the statute. The court held, however, that it was only an irregularity which could be and was, in fact, cured by subsequent notification. Instead of being void, the assessment was merely unenforceable until proper notification had been effected.

In response, it was urged by the Respondent that the finding in **Grunwick** was consistent with the section of **Wade** cited above in that no injustice would be done to the taxpayer if the basis of the assessment, not having been originally communicated to him, this was done at a later stage. I agree with the submission of the Respondent on this aspect of this issue, that when looking at the facts of the present case, there is nothing in the Act or in any decided case cited to the Court, to suggest that a failure to state the basis in the original notice makes the assessment, *per se*, and permanently, invalid.

The Appellant's challenge to treatment as "Distribution"

Counsel for the Appellant also says that the Respondent's Notices are void because they have failed to cite the specific paragraph in the Table under section 34(1), pursuant to which the assessment, on the basis that the transfers were "distributions", was raised. Moreover, it was submitted that "Section 34(1) of the ITA prescribes, in its separate paragraphs, those acts which alone may be treated as distributions for the purpose of the Act". Thus, according to the Appellant, unless the payment fell within an identified paragraph of section 34 (1), while not being excluded pursuant to any exception to that paragraph, then it was not open to the Commissioner to find that there had been a distribution. However, no authority for this proposition is cited.

[7] (1986) STC 441

The Respondent had failed to indicate which part of the Table of section 34(1) applied and provided no evidence to show this. In fact, says the Appellant, it was not until the Appellant had closed its case before the Commissioner of Taxpayer Appeals that the Respondent had indicated that its case was grounded in section 34(1) paragraph 2, set out below. But, says Appellant, that paragraph requires, as a prerequisite, that the payment in question be made "in respect of shares" *and* that it be made out of the assets of the company or so that the cost falls on the company. It was submitted that the payment in question was not made "in respect of shares" and so the payment could not be brought within that paragraph.

Section 34 defines what circumstances qualify as distributions and sub-section (1) provides as follows:

> Any act by a body corporate subject to income tax which falls within any paragraph of the following Table but not within any exception to that paragraph *shall be treated for the purposes of this Act as a distribution by the body corporate,* but, except as provided in sub-section (3) of section 36c, no other act shall be so treated. (My emphasis)

To be a "distribution", therefore, the act must be one within a paragraph of section 34, must not be within any exception to the paragraph and must not be such as would bring it within section 36C(3). The sub-section then goes on to define various acts or circumstances which would amount to "distributions". For ease of reference, I set out below those parts of the sections as may be considered relevant to this discussion.

Table of Company Distributions

> Note: In this Table "capital assets", in relation to a body corporate, means assets not derived from income from which its chargeable income for any year is computed or would have been computed if it were subject to tax.

Distributions to shareholders

1. Any dividend.

Exceptions: (a) so much of any preference dividend as is deductible under subsection (3) of section 13;

(b) so much of any dividend as is proved by the body corporate to have been paid out of capital assets.

2. Any payment, other than a dividend, made (whether in cash, goods or otherwise) in respect of shares in the body corporate out of assets of the body corporate or so that the cost of it falls on the body corporate, excluding such payments made in the winding-up of a body corporate.

Exceptions: (a) so much of any payment as represents a repayment of capital on the shares (including repayment of any premium at which the shares were issued);

(b) so much of any payment as is proved by the body corporate to have been made out of capital assets.

3. As respects any payment made (whether in cash, goods or otherwise) in respect of shares in a company, being a payment made in the winding-up of the company where the sole or main object of the winding-up was to obtain a tax advantage (as defined by subsection (9) of section 18) for any members of the company, so much of the payment as it is necessary to treat as a distribution in order to prevent the tax advantage from being obtained.

Distributions to principal members, etc.

9. The grant of a loan falling within section 35.

Under paragraph 9 therefore, if the loan falls within the provisions of section 35, it will be a distribution pursuant to paragraph 9. For these purposes, I set out section 35(1) of the Act. It reads:

35. (1) A body corporate subject to income tax shall be treated as making a distribution where it grants a

loan, otherwise than in the course of a bona fide business of lending money-

(a) to a principal member of the body corporate or of any other body corporate connected with it; or

(b) to a relative of any such principal member; or

(c) to any other person on terms such that any such principal member or relative indirectly receives the equivalent of the loan or part of it:

Provided that this subsection shall not apply-

(i) if the principal member is a body corporate resident in the Island; or

(ii) if the principal member is a body corporate resident out of the Island and the Minister has approved the loan as being beneficial to the economy of Jamaica; or

(iii) if the loan is granted by a company to a person employed by it where loans on the like terms are made available by the company to all its staff in similar employment.

Was the Commissioner entitled to treat the "transfers" as distributions?

Counsel for the Appellant urged the Court to the view that the decision by the Commissioner to treat the transferred funds as distribution and not as characterized by the Appellant, as loans, was wrong in fact and in law. The starting point of the submission is Appellant's assertion that it only became aware that the Respondent was relying upon paragraph 2 of the schedule in section 34 (1), after it had closed its case before the Commissioner of Taxpayer Appeals. In any event says counsel, the idea that paragraph 2 of section 34 (1) set out above is relevant is "misconceived as the payments were not made in respect of shares of CCJ. Further, the evidence is that the loans were repayable on demand and were in fact repaid and therefore the cost did not fall on the company", both conditions precedent to the loan being considered a "distribution".

Appellant also submitted that, to the extent the anti-avoidance provisions in section 35 sought to bring into charge loans to principal members, the provision was directed to principal members who were individuals. Moreover, and in any event, the proviso to section 35(1) specifically exempted loans to principal members who are bodies corporate resident in the Island. It was submitted that there was evidence to the effect that loans between bodies corporate resident in the island were "specifically exempted, *for the policy of the legislation as determined by Parliament was to grant exemption to such loans made between companies in the same group in accordance with well-established corporate practice for the efficient use of cash resources. This practice has a sound business purpose in terms of economic efficiency and is far removed from the field of tax avoidance*". (My emphasis) This was the view put forward in the statutory declaration of Alistair Macbeath, a former CEO of Carreras Group and former secretary of the Joint Taxation Committee, ("JTC") a committee made up of accountants, lawyers and members of the Ministry of Finance in 1970, which committee liaised with the government in the development of the re-modeled income tax legislation of 1970 and 1971, of which section 34 became a part. In pointing to the affidavit of Mr. Macbeath with its attachments as authority for the meaning to be accorded the provisions of section 34 and 35, Appellant's counsel cites the House of Lords case of **Pepper (Inspector of Taxes) v Hart**[8] where a court had to construe legislation. The legislation in that case was the Finance Act 1976, ss.61, 63 and on appeal the question to be determined by the enlarged appellate committee was whether Parliamentary material could be used in aiding the interpretation of legislation. That case, as I understand it, is being cited here as authority for the proposition that parliamentary material, such as that adverted to by Mr. Macbeath may, in fact, be so used by the Court, in interpreting legislation. In considering this submission, it may be useful to give a short summary of the background to this case.

[8] [1993] 1 All ER 42

In **Pepper v Hart**, a number of school-teachers who were allowed to have their children educated at the private school where they worked, at a reduced cost appealed against the decision of the Revenue to tax them on the basis of the proportional cost to the school, rather than on the marginal cost of the education, which was minimal, as the children were taking up vacant places which the school had been unable to fill.

The minister had given assurances during the passage of the (Finance Act 1976,ss.61, 63) that were considerably more favourable to the taxpayer, Mr. J T Hart, than was indicated by the clear legal meaning of the enactment in question. At first the Board operated the resulting legislation in accordance with those assurances, but later tried to go back on them and implement the legal meaning. That led to the litigation.

The Judges in the case, up to and including the Appellate Committee of the House of Lords, found for the clear legal meaning. However, when it was discovered by a member of the Appellate Committee Lord Griffiths that the minister had given the assurances referred to, the Appellate Committee rescinded its first hearing, added two Law Lords to the usual number, and reheard the matter. After that they declared that the enactment in question was, after all, ambiguous and that justice required that reference be made to Hansard in order to investigate the ministerial assurances.

The relevant legislation, they found, was ambiguous, and on appeal the question to be determined by the enlarged appellate committee was whether Parliamentary material could be used in aiding the interpretation of legislation.

It was held, *inter alia*, that (1) the rule whereby reference to Parliamentary material is prohibited in questions of statutory interpretation would be overturned; (2) where legislation is obscure or ambiguous reference to statements by a minister would be allowed, where such statements were sufficiently clear;

In his affidavit, Mr. Macbeath purports to give *his understanding* of discussions which took place within the JTC during the period when the changes in the legislation, now contained in sections 34 and 35 of the Act, were being contemplated. He also quotes from a Ministry Paper, a Cabinet Submission and a statement to the House of Representatives by the then Minister of Finance. He states, *inter alia*, that "references made by examples as to why section 19D (now section 35) of the Income Tax Act was introduced that are in Ministry Papers, Cabinet Submissions and Hansard are to loans to individuals who were the objects of the anti-avoidance provisions". Further, in the course of paragraph 15 of his affidavit to which the court has been specifically directed, Mr. Macbeath states:

> "Accordingly, in 1971, when I presented a paper at a taxation seminar on the new taxation legislation, sponsored by the JTC, it was unequivocally understood by the Ministry, the Income Tax Department and the business community that group inter-company indebtedness was exempted by the proviso".

I wish to make some observations with respect to this submission and the purported evidence in support. Firstly, There is no indication or language in any of the exhibits to Mr. MacBeath's affidavit which speaks to facilitating inter company loans on the basis that the practice enhanced the central treasury function within groups within groups. Indeed, the Jamaican income tax legislation has consistently turned its face against the concept of "group taxation" which allows the group to be taxed as a whole, rather than as individual companies within the group.

Secondly, there is no reference to "individuals" in any of the exhibits to Mr. Macbeath's statutory declaration. The references are to "principal members", a term defined in the legislation. This provides a fundamental difference between the situation which the court faced in **Pepper** and that faced here. Nor is an assertion about what other persons at a seminar understood from the affiant's

presentation, of help in construing the statute. In any event, according to the doctrine of Pepper v Hart, it is authority where the legislation is ambiguous or is obscure. There is no submission that this is the case here and so Mr. MacBeath's affidavit is not in the same position as the **Hansard** reports which the House of Lords reviewed in Pepper.

In any event, what was produced in **Pepper** was a clear statement of the Financial Secretary as to the way a particular provision was to be treated by the Board of Inland Revenue, which was in fact subsequently acted upon by the Board. Not surprisingly, Professor Bennion has revisited this issue within the context of whether there is a doctrine of "Executive Estoppel". In the instant case, there was no such undertaking or expression of intention by the Minister of Finance. What the Appellant here is asking the court to do is to interpret the meaning of a paragraph of the minister's statement to the House of Representatives, through the prism of Mr. Macbeath's own views of what was the context of the legislation. That is a far way from what is permitted under **Pepper**.

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It should also be noted that the reasoning, if not the decision, in Pepper has come under significant criticism including criticism by the author of one of the leading texts on statutory interpretation, Professor Francis Bennion[9]. In that article Bennion states that:

> ".....through defective law management the Appellate Committee applied the wrong criterion and did not perceive that the relevant enactment failed to satisfy the very tests the Committee laid down allowing such recourse. The enactment was not ambiguous or obscure, and its literal meaning did not lead to absurdity. This leads us to the remarkable conclusion that the case was decided *per incuriam*, and so is no authority at all for recourse to Hansard in statutory interpretation".

Notwithstanding the eminence of Mr. Bennion in this area of law, the above statement may yet be considered a trifle strong. However, a reading of the various judgments of the members of the appellate committee in **Pepper** shows that there was no wholesale acceptance of a principle that recourse to Hansard

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[9] See Bennion: "How they all got it wrong". [1995] British Tax Review 325

was to be a standard part of statutory interpretation. Rather, there was a feeling that if the Revenue was allowed to go back on the assurances given by the Financial Secretary and which had been implemented, it would have been grossly unfair to the taxpayer.

Thus, for example, Lord Mackay of Clashfern, the Lord Chancellor, in dissenting did not feel able to support a general reversal of the exclusionary rule given the real practical difficulties which he envisaged would arise therefrom. He said[10]:

> I fully appreciate and feel the force of the narrowness of the distinctions which are taken between what is admissible and what is not admissible, but the exception presently proposed is so extensive that I do not feel able to support it in the present state of our knowledge of its practical results in this jurisdiction. For these reasons, I agree that these appeals should be allowed, although I cannot agree on the main issue, for the discussion of which this further hearing was arranged.

It was the view of Lord Bridge of Harwich[11] that:

> It should, in my opinion, *only be in the rare cases where the very issue of interpretation which the courts are called on to resolve has been addressed in Parliamentary debate and where the promoter of the legislation has made a clear statement directed to that very issue, that reference to Hansard should be permitted*.

Lord Griffiths, who said he would have construed the provision in favour of the taxpayer even without any reference to Hansard, but nevertheless agreed that it was ambiguous, was similarly circumspect in his acceptance[12]

> The object of the court in interpreting legislation is to give effect so far as the language permits to the intention of the legislature. *If the language proves to be ambiguous I can see no sound reason not to consult Hansard to see if there is a clear statement of the meaning that the words were intended to carry*.

Lord Oliver of Aylmerton who like the rest of the Appellate Committee concurred in the view that the exclusionary rule should be overturned had this to say[13]:

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[10] At page 49 of the Report
[11] See Page 49 of the Report
[12] See Page 50 of the Report
[13] See pages 51-52 of the Report

> My Lords, I have had the advantage of reading in draft the speech prepared by my noble and learned friend, Lord Browne-Wilkinson. I agree with it in its entirety and would, in the ordinary way, be content to do no more than express my concurrence both in the reasoning and in the result. *I venture to add a few observations of my own only because I have to confess to having been a somewhat reluctant convert to the notion that the words which Parliament has chosen to use in a statute for the expression of its will may fall to be construed or modified by reference to what individual members of Parliament may have said in the course of debate or discussion preceding the passage of the Bill into law. A statute is, after all, the formal and complete intimation to the citizen of a particular rule of the law which he is enjoined, sometimes under penalty, to obey and by which he is both expected and entitled to regulate his conduct. We must, therefore, I believe, be very cautious in opening the door to the reception of material not readily or ordinarily accessible to the citizen whose rights and duties are to be affected by the words in which the legislature has elected to express its will.*

Lord Browne-Wilkinson who delivered the leading opinion in **Pepper** cited the hitherto continuing discomfort of judges at the highest level of the judiciary with disturbing the so-called "exclusionary rule" which prohibited reference to parliamentary papers in aid of interpreting statutory provisions. He adverted[14] to the judgment of Lord Scarman in **Davis v Johnson**[15] where, in reference to parliamentary materials, he said:

> "Such material is an unreliable guide to the meaning of what is enacted. It promotes confusion, not clarity. The cut and thrust of debate and the pressures of executive responsibility, the essential features of open and responsible government, are not always conducive to a clear and unbiased explanation of the meaning of statutory language. And the volume of Parliamentary and ministerial utterances can confuse by its very size."

Lord Browne Wilkinson in the course of his leading judgment[16] cited the following:

"In **Beswick v. Beswick [1968] A.C. 58, 74A** Lord Reid said:

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[14] At page 63 of the Report
[15] [1979] A.C. 264, 350
[16] At Page 61-62 of the Report

"For purely practical reasons we do not permit debates in either House to be cited: it would add greatly to the time and expense involved in preparing cases involving the construction of a statute if counsel were expected to read all the debates in Hansard, and it would often be impracticable for counsel to get access to at least the older reports of debates in Select Committees of the House of Commons; moreover, in a very large proportion of cases such a search, even if practicable, would throw no light on the question before the court."

In **Black-Clawson International Ltd. v. Papierwerke Waldhof-Aschaffenburg A.G. [1975] A.C. 591** Lord Reid said, at pp. 613-615:

"We often say that we are looking for the intention of Parliament, but that is not quite accurate. We are seeking the meaning of the words which Parliament used. We are seeking not what Parliament meant but the true meaning of what they said. . .

In the same case Lord Wilberforce said, at p. 629:

"The second [reason] is one of constitutional principle. Legislation in England is passed by Parliament, and put in the form of written words. This legislation is given legal effect upon subjects by virtue of judicial decision and it is the function of the courts to say what the application of the words used to particular cases or individuals is to be. . . . it would be a degradation of that process if the courts were to be merely a reflecting mirror of what some other interpretation agency might say."

Lord Browne-Wilkinson probably best summed up the position of the Appellate Committee in the following passage from his judgment[17]:

My Lords, I have come to the conclusion that, as a matter of law, there are sound reasons for making *a limited modification to the existing rule (subject to strict safeguards)* unless there are constitutional or practical reasons which outweigh them. *In my judgment, subject to the questions of the privileges of the House of Commons, reference to Parliamentary material should be permitted as an aid to the construction of legislation which is ambiguous or obscure or the literal meaning of which leads to an absurdity.* (All the foregoing emphases are mine)

I accept this latter statement of the noble and learned law lord as an appropriate statement of the law and adopt it for the purposes here. Accordingly, I hold that

[17] See page 64 of the Report

the case has no application here. There is no allegation of ambiguity, or obscurity nor any suggestion that the literal meaning of the provision in section 35 would lead to an absurdity. Nothing in the affidavit of Mr. Macbeath remotely brings the submission within the principles carefully enunciated in **Pepper** by the learned and noble Lords of Appeal in Ordinary. I do not accept the view that the section is to be construed as being argued for by the Appellant here.

Are the "transfers in fact distributions rather than loans?

Appellant's counsel submitted that, in any event, even if the loan is treated as a distribution under section 35, CCJ is entitled to the benefit of Section 35 (3) of the ITA which provides as follows:

> Where the whole or part of a loan treated as a distribution is repaid in a subsequent accounting period of the lender beginning not later than five (5) years after the date of the loan, such repayments of tax (if any) shall be made as are necessary to restore the persons concerned to the position they would have been in if the loan, or that part of it, had not been treated as a distribution.

Appellant asserted that in this case, the whole of the loans now being treated as distributions had been repaid in "a subsequent accounting period of the lender" as the affidavit evidence showed that the sums in question had been repaid in the course of the reorganization in February and March 2004 For the moment, it is sufficient to deal with this proposition by pointing out, as the Respondent in her Statement of case has done, that there were no repayments of any of the "advances" by CGL for over ten (10) years, and the statute clearly had a five (5) year window in which the repayment should have taken place in order to qualify under the provision in section 35(3). Indeed, there was no assertion or evidence to the effect that there would have been any repayment of any of the "loans" but for the fact of the proposed reorganization of the group.

For the Respondent it was contended that she was entitled to treat the transfers as distributions as they were not loans within the meaning of section 35 of the Act; that they were distributions subject to tax under section 5(1)(b)(iv) and

section 34 (1) paragraph (2). Further, that section 16, the anti-avoidance section conferred the power upon the Commissioner to thwart tax avoidance schemes where the circumstances detailed in that section were satisfied.

I have already set out section 34 (1) paragraph 2 above. Section 5(1)(b)(iv) and section 16 of the Act are respectively, in the following terms.

> 5. (1) Income tax shall, subject to the provisions of this Act, be payable by every person at the rate or rates specified hereafter for each year of assessment in respect of all income, profits or gains respectively described hereunder- ...
>
> (b) profits or gains accruing in or derived from the Island or elsewhere, and whether received in the Island or not in respect of-
>
> (i) dividends (other than those falling within exception (b) of paragraph (1) of the table contained in section 34), discounts, interests, (including interest referred to in section 31A), annuities, pensions or other annual sums;
>
> (iv) distributions (not falling within sub-paragraph (i)) by a body corporate subject to income tax;

It will be apparent that pursuant to section 5 (the charging section) "distributions" which are not "dividends" under section 5(1)(b)(i) may nevertheless be subject to income tax under section 5(1)(b)(iv).

Section 16, the anti-avoidance provision, is in the following terms.

> 16. (1) Where the Commissioner is of opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious, or that full effect has not in fact been given to any disposition, the Commissioner may disregard any such transaction or disposition, and the persons concerned shall be assessable accordingly.

The essence of the Appellant's contention

It was Appellant's essential contention that the transfers were genuine loans from CCJ to CGL and thus there was no basis for treating them as other than loans under the provisions of section 16, anymore than under section 34. In the words of Appellant's submission:

> The central feature of a loan transaction is that the parties must intend that the whole of the monies lent should be repaid. The central issue here is the factual one of whether, at the time of the advances in question, there was a definite intent to repay the advances. That subjective intent of the parties to the transaction is determined by examining all the circumstances of the transaction, including its objective factors such as the ability of the borrower to repay the loans.

Counsel for the Appellant submitted that section 16 of the Act, which was given by the Respondent as one of the reasons for the assessment, had no application here. According to this view, the power of the Commissioner to treat any transaction as artificial or fictitious was only available when the Commissioner finds that a transaction reduces or would reduce the amount of tax payable. Counsel submitted that there was no evidence, in any of the affidavits from the Revenue, that there was any reduction or possible reduction of taxes. According to the Appellant's counsel's submission: "Neither the Statement of Reasons nor the Affidavit nor the Statutory Declarations of Vinette Keene filed herein disclose any reduction in taxes which would have been payable by CCJ had the transaction been disregarded".

It seems to me that this is a misreading of the statute. The statute allows for the power of the Commissioner to be exercised (that is, the power to raise an assessment) where she is "*of the opinion that any transaction which reduces or could reduce the amount of tax payable is artificial or fictitious or that full effect has not, in fact, been given to any disposition*", she may "disregard any such transaction or disposition" and the persons concerned "shall be assessable accordingly". In these circumstances, if the effect of treating the transaction as a

"loan" rather than a "distribution" subject to tax is, or may be, to reduce the tax payable, then it would appear that providing the Respondent was of the opinion that such was an artificial or fictitious transaction, she could raise an assessment. Further, if, in her view, *full effect has not been given to the transaction*, then she may disregard the transaction and make the assessment. I understand this to mean that the Commissioner's right arises if she finds that transaction which is in reality one thing, (a distribution) is being put forward as something else, (a loan) with different consequences.

It was also suggested by Appellant that the Commissioner's power under section 16 to "disregard" any transaction, was not a power to "characterize" it as something else, but only to proceed as if it never took place. This submission also seems misconceived for it ignores the consequential power of the Commissioner to then assess such persons "accordingly". If there is a power to assess once she has satisfied herself as to the basis for forming the appropriate opinion, that power could only arise on the basis that the transaction which is to be "disregarded" is in fact something else, and she must say what that is ("characterize it") in order to show that it is subject to tax. To "disregard" here, does not equate to "pretend the transaction never took place". Rather, it means to disregard the transaction in terms of the characterization accorded it by the actors, and to accord to it the characterization which properly it deserves. If it were to be interpreted in the literal way suggested by counsel for the Appellant, there could never be any basis for an assessment under section 16.

"Artificial or Fictitious" under section 16

It is as well to bear in mind, as was submitted by Respondent, that the power given to the Respondent under section 16 is in relation to "artificial" or "fictitious" transactions. The two terms are not co-terminous. Indeed, Respondent concedes that the transactions were not "fictitious" as there were in fact, actual transfers. They were not merely book entries. What was submitted, however, was that the transactions were "artificial" to the extent that they were designated as loans,

while they were not. Counsel for the Respondent submitted that there was authority for treating the transfers as "artificial". He cited the local case of **Liner Diner (1968) Limited AND E.S. Campbell & Co. Ltd v The Commissioner of Income Tax**[18]. In that case Marsh J. discussed the meanings of the words "artificial" and "fictitious", then contained in section 10 of the Act. He said:

> If therefore, I may express the matter in my own words, I would say that within the context of section 10 (1), a fictitious transaction is one that has form but no substance, in the sense that none of the parties involved intend to create any real or legal relationship thereby, in short a feigned transaction. On the other hand, an artificial transaction is one that has both form and substance, except that the form is used merely to disguise the substance;

The learned judge went on to say that the use of the word "transaction" implied that some sort of arrangement exists between two or more persons, and accordingly, in determining whether a transaction is caught by the section "regard must be had not only to the transaction itself, but to all the surrounding circumstances, including the relationship between the parties, which in the case of a company would include its directors and shareholders."

The meaning of the term artificial or fictitious was also considered in another Jamaican case heard by the Privy Council, **Seramco Ltd. Superannuation Fund Trustees v Income Tax Commissioner**[19]. In that case Lord Diplock said:

> "Artificial" is an adjective which is in general use in the English Language. It is not a term of legal art; it is capable of bearing a variety of meanings according to the context in which it is used. In common with all three members of the Court of Appeal, their lordships reject the trustees' first contention that its use by the draftsman of the subsection is pleonastic – that is a mere synonym for 'fictitious'. A fictitious transaction is one which those who are ostensibly the parties to it never intended should be carried out. 'Artificial' as descriptive of a transaction is, in their Lordships' view, a word on wider import.

His Lordship, however, declined to lay down any further definition of the word 'artificial'. He said:

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[18] Revenue Appeals Nos. 12 and 13 of 1972 decision April 12, 1973
[19] [1976] STC 100

> Where in a provision in an Act an ordinary English word is used, it is neither necessary nor wise for a court of construction to attempt to lay down in substitution for it, some paraphrase which would be of general application to all cases arising under the provision to be construed. Judicial exegesis should be confined to what is necessary for the decision of the particular case.

He suggested, and I adopt the learned law lord's suggestion, that what a court should do is to look at the particular transaction to see whether the particular transaction in question "is properly described as 'artificial' within the ordinary meaning of that word". In this case, the court must consider whether the circumstances would fall within a definition of the word artificial. It is to be noted that, as submitted by Respondent's counsel, among the circumstances revealed by the evidence and which the Respondent would have considered in the determination of whether the transaction was properly characterized as 'artificial' were the following facts:

(a) The absence of any agreement outlining terms of repayment;

(b) The degree of disparity between the amounts that were declared by the Appellant as dividends and the amounts that were transferred to Carreras as loans, during the relevant period;

(c) The similarity between the sums which were paid to Carreras as loans and the annual profits of the Appellant,

(d) The absence of any indication of the loans being repaid prior to 2003, and

(e) The absence of any security for the loans and the fact that the loans were interest free.

It was these factors which would have encouraged the Respondent to the view that the transaction was artificial within the meaning of section 16. In the closing submissions for the Respondent it was suggested: "It is hard to imagine what could be more artificial than a loan arrangement which was totally in the control of the debtor and which only provided economic benefits to the debtor and no financial return to the lender. The debtor paid no interest and gave no security. It

could borrow as much as it wished (the only limit being the amount which the lender had available) and could keep it as long as it wished".

Notwithstanding this, Appellant insists that the transfers were genuine loans. In its submission, Appellant submitted as set out above, that the "*subjective intent of the parties to the transactions is determined by examining all the circumstances of the transaction*, including its objective factors such as the ability of the borrower to repay the loans". This submission was made based upon dicta cited below from **Byorick.** However, as I shall point out below, it is not an accurate reflection of what was said in that case, nor does it capture what I believe were the thoughts that the court there sought to convey. But there is also a part of the submission which is in the following terms:

> The central feature of a loan transaction is that *the parties must intend that the whole of the monies lent should be repaid*. The central issue here is the factual one of whether, at the time of the advances in question, there was a definite intent to repay the advances.

It was the essence of the Respondent's response to Appellant's submissions that the central issue of whether there was an intent to repay is not determined by the say-so of officers or directors of the Appellant or its parent, the CGL Group, but that issue was to be determined by looking at all the objective factors. I shall later on look at some of the authorities cited In support of these submissions as to the objective basis of determination.

In support of the central submission that the essence of a loan is the intention of the borrower and the lender that the sums be repaid, counsel for the Appellant cited a number of authorities including the United States of America Tax Court decision in **M.J Byorick Inc. v Commissioner of Internal Revenue**[20] . In **Byorick** the principal shareholder of the company took a series of "advances" from the company over several years. The Internal Revenue sought to raise assessments in respect of these advances on the basis that they represented

[20] 1988 WL 56415 (US Tax Ct) 55 T.C.M. (CCH) 1037

"constructive dividends". In considering whether the advances were "constructive dividends" the court, (Judge Scott presiding) delivered itself of the following:

> Whether advances are loans or constructive dividends is a question to be decided based upon the facts and circumstances in the present case.

After citing some authorities in support of the above proposition Judge Scott continued[21]:

> The standard to be applied is whether both the borrower and the lender intended at the time the advances were made that these advances be repaid. **Estate of Taschler v United States 440 F.2nd 72, 75, (3rd Cir 1971);** Commissioner v Makransky 321 F 2nd 598 (3rd Cir. 1963) affirming 36 T.C. 446 (1961); Haber v Commissioner 52 T.C. 255, 266 (1969), affirmed 422 F. 2nd 198 (5th Cir. 1970). *That subjective intent of the parties to the transactions is determined from their objective manifestations.* (Emphasis Mine)

I adopt the reasoning inherent in the dicta of the learned judge for what the court is saying is that in order to determine what the parties intended, one must look at the objective data, the "objective manifestations". Those manifestations are revealed by the evidence available to the court. Thus, as the court stated, while a borrower's complete control of the lender is a factor to be considered in making that determination and will "require close scrutiny", it is not determinative of whether loans made in these circumstances are real loans or not. The court's words are extremely instructive.

> However, to hold that shareholder control in and of itself repudiates the bona fides of a loan would be to say that a corporation may never make bona fide loans to its shareholders. We agree with respondent that loans where the debtor and the creditor are in effect one and the same, creates obvious difficulties. That is, of course, a reason for applying the close scrutiny called for in such a situation.[22]

It is, therefore, a matter of what the evidence reveals. In **Byorick**, almost every single advance was duly evidenced by an interest-bearing promissory note with a rate of interest noted thereon. The evidence also clearly established that the shareholder made regular and consistent payments of principal and interest

[21] Page 20 of the Report
[22] Page 20 of the Report

against these loans notwithstanding that subsequent loans often mirrored the amounts repaid by the shareholder. Indeed, it was the contention of the shareholder in the case that "the evidence clearly establishes his intention and that of the company to treat the advances as loans and to require repayment. In addition he argues that he had a reasonable basis for expecting that the loans would be repaid". Thus, as the court noted, "Petitioner's insistence upon loan documentation is relevant to the intention to repay". Similarly, "repayments of principal and interest are further indications of intention to repay".

It is not surprising that given the weight of the evidence in this case the court concluded:

> After considering the record herein, we conclude that both the petitioner and his company did intend for the advances made to the petitioner to be repaid. Petitioner presented credible testimony of this intent which was un-rebutted by respondent.

I am of the view that the learned judge has carefully chosen his words in stating the court's conclusion. He has not said that the statements of intention by both the petitioner and the company which he controlled as to the intent to repay were determinative of the issue of whether there had been a loan. Rather, he has said that in looking at the totality of the record, that is, all the evidence before him, he has arrived at a certain conclusion. I make this point here because the Appellant's counsel is insistent that the evidence of George Ashenheim to the effect that there was always an intention to repay, ought to be accepted as conclusive as there is no direct evidence to contradict it. It is clear, therefore, that based upon the authorities, a mere expression of subjective intent to repay stated by the parties, moreover one stated ex post facto the nature and character of the transactions being called into question, cannot be conclusive of the issue of whether the transfers were indeed loans,

Other cases cited by Appellant's counsel in support of the proposition that subjective intent is the touchstone by which the character of the transfer is to be determined are **DZ & Commissioner of Taxation AND PB Pty Ltd v**

Commissioner of Taxation Re D W Muller, Senior Member[23]; **AAT Case 10, 636 J Block, Senior Member, C Prime and P M Greenwood, Members**[24] and **Richard Walter Pty Ltd v Commissioner of Taxation**.[25] This last case referred to was the report of the first instance trial before Tamberlin J, but I shall refer below to the decision of the Court of Appeal in the same case below.

In the first of the trio of cases referred to above, (**DZ and Commissioner**), the headnote is as follows:

> The taxpayer, his four (4) sisters and his brother collectively owned 49% of the shares in a successful family company. The remaining 51% of the shares were owned by their parents who had established the company. The parents wanted to transfer family assets to their children while retaining 51% of the shares in the company. In the case of the taxpayer who had played an active role in running the company, this was achieved by transferring to him his siblings' shares in the company. This gave him a 49% interest in the company worth $3 million. The four sisters received property and other assets worth $1.5 million and the brother received $1.5 million in cash. The $1.5 million was funded by a loan from the family company which the taxpayer was required to repay. The Commissioner considered that the loan was a sham because:
>
> a) at the time of the loan, the taxpayer had no hope of repaying it;
> b) it was not until the taxpayer was audited a few years later that he made any effort to make repayments; and
> c) the taxpayer would eventually become the sole shareholder of the company at which time he could forgive his own debt.
>
> The Commissioner therefore deemed the loan to be a dividend and assessed the taxpayer accordingly. The taxpayer's objection was disallowed and he applied for a review of that decision.
>
> It was held setting aside the objection decisions under review that the evidence showed that the loan was a genuine transaction and not a sham and therefore the loan was not a deemed dividend. It is interesting to note that among the reasons for that decision were the findings the taxpayer would have been able to repay; that when he sold his family home, he had used part of the proceeds to repay $90,000.00 of the loan; the absence of payments in the 1994-95 tax year before the tax audit could be explained by the illness of his solicitor and the family accountant; it flew in the face of common sense to suggest that the taxpayer's siblings

[23] 42 ATR 1062
[24] 32 ATR 1109
[25] 31 ATR 95

would allow him to keep assets of $1.5 million for himself when eventually they would become entitled to five-sixths of those assets.

In the second of the cases, (**AAT 10, 636**) the following appears from the headnote:

> The taxpayer sought a review of decisions by the Commissioner of Taxation disallowing objections to notices of amended assessment which included in the taxpayer's income amounts deemed to be dividends pursuant to s 108 of the Income Tax Assessment Act 1936 (Cth) (the Act). It was conceded by the Commissioner that the payments giving rise to the dividends were not "shams" and that therefore s 108 was applicable. Further, the Commissioner did not dispute the quantum of each deemed dividend. The issue was whether it was reasonable that the commissioner formed the opinion that the distributions in question were distributions of profits within s 108 of the Act.
>
> The taxpayer received the dividends in question from a company (the company) of which he and his wife were the only directors and shareholders. The taxpayer and his wife received a salary and a deemed dividend from the Company and at the same time were indebted to the Company. The taxpayer and his wife reduced the balance of the loan account using funds obtained, inter alia, from the sale of a property. The Commissioner argued that the loan(s) in question were not genuine loans but did not clarify the difference between a "genuine" and a "non-genuine" loan. The taxpayer and his wife admitted that they treated the funds of the Company as their own funds.
> It was held inter alia:
> (i) In categorizing a loan as genuine or not, the question of intention to repay was decisive.
> (1950) 1 CTBR (NS) Case 80; Case 69 (1950) 1 TBRD 260, followed.
> (ii) The description of the payment given by the parties was relevant but not decisive in determining the nature of the transaction.
> (iii) The substance and not the form of the transaction was relevant as was documentation evidencing the transaction which indicated the intention of the parties.

In that case, the court found in favour of the Revenue in circumstances where the taxpayer professed an intention to repay, but there was no fixed time for repayment and the taxpayer said the loan would be repaid whenever the funds were required by the company. In fact, in that case, there were some repayments, whereas in the instant case at Bar, there were no repayments before the Respondent raised the assessments.

It will be recalled that the Appellant here had cited these cases in support of the proposition that an intention to repay was decisive in determining whether a transfer was a genuine loan or something else. What emerges from the decisions above does provide some confirmation of the proposition that the intention to repay is an essential criterion of a valid loan. What is equally to be adduced, however, is that the intention to repay is not to be determined on the basis purely that the borrower said he intended to repay. Rather, it is for the court to view all the objective factors to ascertain whether there was a real intention to repay. Thus, as was said in **AAT 10, 636,** the description of the payment given by the parties *was relevant but not decisive* in determining the nature of the transaction and it was the *substance and not the form of the transaction* which was relevant, as was documentation evidencing the transaction which indicated the intention of the parties. As was noted in the **DZ and Commissioner** case above, the court paid special attention, not to what the taxpayer said he intended, but to the fact that he did make a payment when he sold his family home *and* that the absence of payments prior to the tax audit were explainable from the evidence, on an objective basis because of the illness of his solicitor and family accountant.

Appellant submitted that in considering whether the transfers were genuine loans, there was clear evidence of an intention to repay in the statutory declarations filed in support of the appeal. Mention is made, in particular, of the declarations of George Ashenheim and Marlene Sutherland, the former Financial Controller, then finance director, of CGL.

Mr. Ashenheim, who appeared in person to give evidence, stated in his declaration that there was definite intention on the part of both the Appellant and CGL that the "loans" were to be repaid. It was suggested that support for this is found in the statutory declaration of Marlene Sutherland who testified to the "policy" which informed the transfers to CGL. However, Mrs. Sutherland was referring to the policy of the transfer of surplus funds in subsidiaries to a central

treasury in the parent company, for nowhere in her declaration does she say that the sums so transferred were loans subject to repayment. In fact what she said in paragraph 14 of her Declaration is that as there was no repayment schedule for the loan "*the legal position as I understood it is that the loans were repayable at once whenever required by CCJ.*" This was a view also shared by Mr. Ashenheim as indicated in paragraph 20 of his Declaration. Appellant cited **Chitty: The Law of Contracts 26th Edn. Volume 2 para 3854** as authority for the proposition that where money is lent without a stipulation for time of repayment, a present debt is created which is generally repayable at once without any previous demand. The submission is supported by two old cases of dubious value, one dating back to the first half of the Nineteenth Century.

It is also interesting to note, according to paragraph 16 of Mr. Ashenheim's declaration, that under the 1977 Agreement between CGL and CCJ, (to which reference will be made later), "CGL *at its sole discretion* could borrow from CCJ such amounts as it may from time to time require, at such times and in such manner as CGL and CCJ may mutually determine". Both Marlene Sutherland and George Ashenheim are, of course, witnesses of fact and in some respects, the only witnesses of fact as to the transactions now being called into question. It is to be further noted that, apart from the suggestions about intent to repay in their declarations, Appellant is relying on the fact that the transfers were characterized in the accounts of both CCJ and CGL as loans or inter-company balances, as to which, please see my comments on Linroy Marshall's evidence below Regrettably, there is no support for this assertion by way of a single reference in the minutes of either company covering the ten (10) year period up to 2002 about the making of loans or repayment obligations. Nor, as Respondent's counsel points out, was there any explanation given at general meetings of CGL where questions were raised about the large cash balances which that company held, that these were sums repayable to the subsidiary, CCJ. There seems to be a sense in which the Appellant is saying that since the transfers were loans, then there must have been an intent to repay. It seems to

me that based on the authorities, it is the intent to repay which will be one criterion in establishing the fact of the loans, rather than the other way around.

There are two other points which emerge from an examination of the evidence of Mrs. Sutherland and which are worthy of comment. She noted in paragraph 15 of her Declaration that "*the need to repay the loans first arose when CGL decided to streamline its group operations*". She also, during cross examination gave evidence which confirmed that during the period in question CCJ did, in fact, need funds prior to the "streamlining of operations", and accordingly, it entered into arrangements with its bankers for funds to be advanced to it. It is to be noted that she said that there were many such arrangements. Mr. Ashenheim also confirmed this and suggested that this was a case of "one hand not knowing what the other was doing, an apparent acknowledgment that this did not make commercial sense.

There was also the evidence from Mrs. Sutherland where she suggested that the Appellant's bankers (BNS) required it to take out overdraft facilities as a condition of the bank issuing letters of credit or guarantees on its behalf and that such overdraft facilities would have had to be taken out by CCJ even if it had in place cash balances at the bank to cover the amounts to be guaranteed. If this was in fact the case I would find it most curious as it is difficult to understand why a bank would refuse to accept cash held by a customer in the bank as security for any guarantees required to be issued by it on the customer's behalf, especially if the cash in the customers account exceeded the amount required to be guaranteed.

The evidence of Mr. Linroy Marshall, a partner in the auditing firm KPMG Peat Marwick, purported to be factual but was really directed to showing how the transactions were represented in the financial statements. I find instructive his statement in paragraph 10 of his declaration that "A loan creates an obligation on the borrower to repay the loan to the lender". It is also interesting that he states in the same paragraph that "Initially, the disclosures in the Balance Sheet of each

of the companies (referring to CGL and CCJ) combined intra-group trading balances with loans. As of and for the year ended March 31, 1991 and thereafter, inter-company loans were, consistent with Generally Accepted Accounting Principles in Jamaica, presented separately from intra-group trading or current account balances in the Balance Sheets of each of CGL and CCJ. The loans were presented as "Due from Parent Company" and classified as a non-current asset in the Balance Sheet of CCJ and as "Due to subsidiary" and classified as a non-current liability in the Balance Sheet of CGL.

I pause here to make two (2) observations. In the first place, Appellant has proceeded to make submissions on the basis that the loan was repayable by CGL "on demand" by CCJ. (See the cite of Chitty above) However, since the "loans" were classified as "non-current Liability" in CGL's Balance Sheet according to Mr. Marshall, it seems clear that neither the auditors nor the management of CGL anticipated meeting an obligation to repay within a period of one year, which would have made the liability a "current or short-term" liability as opposed to a "non-current" liability. As to this conclusion and its implications, see the reference to this issue in the judgment of Hill J. in my discussion of the Richard Walter case, below[26]. Secondly, I accept the submission of Respondent that the authorities are clear that however the taxpayer may have decided to characterize the transaction in its accounts, this does not affect the substance of the transaction and so Mr. Marshall's declaration is not particularly helpful. I have already commented above on the statutory declaration of Macbeath for the Appellant and re-state that he provides little if any by way of factual evidence upon which this court may rely in determining the central question in this case..

It is appropriate to note here, with respect to the evidence purportedly proffered by the Appellant, that the statutory declarations sworn by Brian Young, and Roy Collister offer opinions in respect of the treatment to be accorded to the transfers, In particular they speak to the "sound commercial practice" of transferring un-

[26] See page 55 below.

utilized cash reserves of subsidiary companies up to the parent company in order to facilitate the efficient working of a central treasury management function. However, it should be noted that neither of these eminent gentlemen is a witness of fact in relation to any issue in this case which arose between 1997 and 2002. They cannot speak with first-hand knowledge of the internal workings of the Appellant and its parent company. In these circumstances they merely offer opinions as to general practice. Nevertheless as correctly pointed out by Respondent's counsel, neither was designated an expert witness pursuant to the Civil Procedure Rules, 2002, upon whose opinion evidence a court may rely.

In addition to the submission that there was always an intention to repay, and that this should be determinative of the issue, the Appellant submitted CGL always had the ability to repay and that the transfers were part of a sound commercial practice to transfer excess cash from operating subsidiaries to a central treasury. These transfers are in accordance with "normal commercial practice" as it is "well recognized that it is a highly undesirable practice to leave cash resources at the subsidiary level. By centralizing the treasury function, it restricts the tendency of subsidiary management to exceed budgeted expenditure. Accepted best practice is to transfer surplus funds to the central treasury of the parent as inter-company loans". This proposition is repeated in several different ways and is supported by assertions such as that "Subsidiaries are required to concentrate on their core businesses. Staff employed by CGL were in the best position to assess the operating companies' needs for cash and operating capital. Accordingly, the cost of operations was reduced by eliminating the need to employ additional staff to manage surplus cash at the subsidiary level". There is of course no empirical evidence to support these propositions in the instant case.

There were also assertions that a central treasury "wields greater influence and clout in negotiating with financial institutions", and that in any event, "it was a highly undesirable practice to leave cash resources at the subsidiary level". The

evidence in support of these assertions is provided by the statutory declaration of Marlene Sutherland. One of the benefits of this centralized treasury function would be to allow for the deployment of cash resources throughout the group in such a way as to minimize external borrowing. It is passing strange therefore, that in at least one instance, there was firm documented evidence that at the same time that significant funds were transferred to CGL interest free, the Appellant was negotiating a loan with the Bank of Nova Scotia on which it had to pay interest and other charges. It would certainly not be an unreasonable conclusion to draw that the Appellant did not get the touted benefit from this bargain in this regard. There was also evidence that other subsidiaries also borrowed directly from CCJ rather than from the central treasury controlled by CGL.

It was a part of this submission that, because of the nature of the arrangements, the inter-company loans would have no fixed maturity date, and so nothing turned on the absence of such repayment date. Further, that the CGL Group practice in relation to the movement of funds served an important business purpose. These assertions rest upon the statutory declarations of Mr. Bryan Young and Mr. Roy Collister. Since neither of these deponents is a witness of fact nor an expert witness as noted above, their evidence must at best be hearsay and at worst opinion. In either case, the court can find no assistance in them.

Another submission with respect to the character of the transfers sought to respond to the fact that no interest was charged on the "loans". According to both George Ashenheim and Marlene Sutherland, the decision was taken for CGL to forego the royalties to which it was entitled under the 1977 Agreement in return for getting these interest free loans. Apart from the say so of both these persons, there was no evidence of any such decision being canvassed at any meeting of the shareholders or directors of either company. The fact is that the 1977 Agreement, which was the foundation agreement for the establishment of the

Appellant, specifically provided for the payment of royalties by the Appellant. This agreement for CCJ to pay royalties may even be in a way a reflection of the specific permission for the merger of B & J. B. Machado and Carreras of Jamaica Limited given by the Government of Jamaica in the letter of Mr. Roderick Rainford on behalf of the Ministry of Industry and Commerce dated July 14, 1977, and appended to the statutory declaration of Mr. Ashenheim as Exhibit GA6. That letter gave specific commitment for the Government of Jamaica to "allow the Cigarette Company of Jamaica to pay such dividends as will be adequate to allow for the Carreras Group to have sufficient profits to pay its shareholders up to the maximum allowed from time to time by Government". It also provided for management fees to be paid to both Carreras Group and to Rothmans by CCJ.

It would not have been unreasonable to have expected that any decision by CGL to forgo the payment of such royalties, (as well as dividends and management fees) which would seem to be a major departure from the terms of the 1977 Agreement, would have been taken either at a shareholders or directors meetings of CGL. However there is no evidence from either Mr. Ashenheim (who was a director of the company since 1962) or Mrs. Sutherland (who had been the Financial Controller of CGL since 1980 and the Finance Director of CGL since 1989), that any such decision was taken at a shareholders or directors meeting of the company.

Given the fact of Mrs. Sutherland's evidence that she was not aware of any calculation being done to determine either the value of the royalties that were foregone by CGL for the use of the trademarks or the interest that was not charged by CCJ on the loans made to CGL, the question may well be asked as to what was the basis of such a decision if indeed it was made. According to the witness, Mrs. Sutherland, this court should accept uncritically the assertion that it would have been commercially prudent for CCJ to have made the decision not to charge interest on the large sums loaned to CGL in exchange for CGL not

charging it royalties, without there being any assessment as to the quantum of the royalty that would have been payable to CGL and the quantum of the interest that CCJ could have earned on the sums that were loaned to CGL. In my view, such a conclusion would be inconsistent with the conduct of a company which, on the evidence of its experienced Finance Director, was insistent upon the most efficient use of the Group's cash reserves through the use of a central treasury.

Respondent's Response to Appellant's claim: transfers were "loans"

The Respondent disagrees with the propositions of the Appellant that either the transfers were exempt distributions or were "loans". Its essential submission in so far as the character of the payment is concerned is in the following terms:

> It is important that we be clear as to the issue being considered. The issue is not whether from an accounting point of view the transactions were properly documented as loans, or whether the two companies acted "improperly" or not. The issue is not whether maintaining a "treasury arrangement" is objectionable or whether there is anything unusual about transfers of funds between companies or within a group of companies.
>
> *The issue is simply whether these transfers from CCJ to Carreras were "loans" within the meaning of the Income Tax Act. The determination of this issue involves both an interpretation of the statutory provisions and a consideration of the relevant facts of this case.* (My Emphasis)
>
> Indeed, CCJ has not only been deprived of the returns on the funds, but the value of the money that they have been repaid in 2004 is substantially less as a result of inflation and devaluation than the value of the sums transferred.

The Respondent's first disagreement with the case being put forward by the Appellant is on the basis that section 5, the charging section, applies since it specifically charges distributions. The transfers were distributions. Respondent's counsel disagrees that the Commissioner has not stated a basis for the assessment or that it is necessary to specify which particular paragraph of section 34 is the applicable paragraph. In any event, with respect to Appellant's

challenge to the charge being under paragraph (2) of section 34, it is responded that the terms of that paragraph are in fact fulfilled. It is submitted that the payment was, in fact, made "in respect of shares" since on Mrs. Sutherland's own evidence, the transfers were to CGL as the parent company who had the central treasury. Further, it was submitted that the second prerequisite of the paragraph is in the alternative. In the circumstances, it is necessary in order to fulfill the criteria of the paragraph that the payment be made *either* out of the assets of the company *or* so that the cost fell on the company. The Respondent submits that it is clear that the transfer was made out of the assets of the company. The sums would otherwise have been part of its cash reserves or retained earnings of the Appellant.

With respect to these submissions, I have said enough above to indicate that I do not agree that the basis of the assessment has not been stated and as such the assessment is invalid. Nor do I agree that the failure to specify which paragraph in section 34 is applicable until the hearing before the Commissioner of Taxpayer Appeals is fatal to the assessment.

Secondly, the Respondent also disagrees with the Appellant on the application of the provisions of section 35. Section 35 in relevant part cited above, speaks to where a "loan" is made by the body corporate otherwise that in the course of carrying a bona fide business of lending. In response to Appellants submission that it is entitled to the exemption on the basis that the "loan" was made to a "principal member who is not an individual" and that CGL was a body corporate resident in the Island {section 35(1)}. There was the further submission that section 35(3) also operated to exempt the payment from being treated as a distribution because it was repaid in a subsequent period.

I have already commented on the evidence of Mr. Macbeath which was relied upon as showing that the anti-avoidance provisions of section 35 were only intended to apply to individuals who were principal members, but not to bodies

corporate. Respondent submitted that it was inconceivable that the legislature could have intended to have an anti-avoidance provision which distinguished between natural and corporate persons. With respect to the exemption under section 35(3), the repayment in a subsequent accounting period of the lender within five years, it was clear that the "repayment", if such it was, came outside of the period contemplated by the statute. It is clear from the authorities cited by the Respondent and those cited by the Appellant upon which the Respondent also relied, that the essence of the Respondent's case is that there was no "bona fide loan". The transfers were not, nor were they intended to be "loans" and the first time they were being characterized as such was when the issue of the reorganization came up. The enormous inter-company indebtedness had then to be dealt with. In Respondent's submission therefore, section 35 has no application as there were no real "loans".

Finally, Respondent's counsel defended the assessment on the basis that transaction was "artificial" although not fictitious and that accordingly section 16 applied. It was not, in the words of Lord Wilberforce[27] cited by the Appellant, "what it is said to be" and accordingly the Commissioner was fully entitled to raise the assessment pursuant to section 16. The transaction was artificial within the terms of the judgment of Marsh J. in the Jamaican case, **Liner Diner** in this court as well as the judgment of the Privy Council in the **Seramco** case, both referred to above[28]. The purported transactions have also reduced the amount of tax which would have been payable because, had the transfers been properly made by way of distributions to the parent company, CCJ not being a company quoted on the Jamaican Stock Exchange would have had to deduct withholding tax. In the words of Respondent's submission:

> Had the amounts been distributed to Carreras they would have been subject to income tax, as section 5(1)(b)(i) of the Act imposes tax on any distribution made by a company not trading on the Jamaica Stock

[27] Lord Wilberforce in Ramsay 1982 A.C. page 300 at 323-4
[28] Both cited on page 32 above

> Exchange. CCJ is a private company and does not trade on the Jamaica Stock Exchange. The Commissioner is of the view that these amounts were transferred for the exclusive benefit of the parent company as "loans" in order to avoid the incidence of income tax. The transfers of funds from CCJ to Carreras were, therefore, treated by the Commissioner as distributions made by the subsidiary to its parent company.

Respondent's counsel in the course of his submissions on the substantive issue of whether the transfers were in reality loans, pointed to several of the matters to which Appellant had referred in its submissions. It was the Respondent's position that the absence of a fixed repayment schedule or date, the lack of provision of any security or for any interest until after the issue of the transfers was raised, despite huge sums of money being "loaned", were clear indications that no "loan" was intended. Counsel for the Appellant also pointed out that despite the protestations of Appellant that the sums were not transferred "in respect of shares", it was clear that the ownership if approximately 99.8% of the shares in the Appellant was the only basis on which the transfers could be explained.

Respondent also pointed to another feature of the transfers to the parent company which it submitted raised further questions about the legitimacy of the claim that they were loans. In some of the years in question, while the Appellant was transferring sums in excess of one billion dollars of profits it had made in the accounting year to its parent company, it declared dividends of less than five (5) million dollars by way of dividends. A quick calculation indicates the percentage of the profits distributed by way of dividends was less than one-half of one per cent. To the non-CGL shareholders, the dividend payment in cash would have amounted to about $100,000.00 per annum, although there is evidence that some bonus shares were issued to shareholders.

Before going on to deal with the Australian case **Richard Walter PTY Limited v Commissioner of Taxation**[29] cited by both Appellant and Respondent, I wish to consider one further submission of the Respondent as to the treatment to be

[29] 32 ATR 95

accorded the transfers. The Respondent's counsel also submitted that the issue of whether the transfers were loans or something else was a matter both of statutory interpretation as well as a consideration of the facts. The facts are largely agreed between the parties. Where there is no agreement is the implications of those facts.

Appellant in seeking to place a restricted interpretation upon the provisions contained particularly in sections 34 and 35, have called in aid the statutory declaration of Alistair Macbeath. I have already dealt with that submission in considering the authority of **Pepper v Hart**. As indicated there, I do not accept that the statutory declaration provides evidence supporting the proposition argued for concerning the interpretation of the sections. The Respondent on the other hand urges the court to adopt, what is referred to as a more purposive interpretation of the provisions.

Counsel submitted that, in what is now widely seen as a substantive departure from the position articulated in the **IRC v Duke of Westminster**,[30] the courts in a number of cases starting with **Ramsay (W.T) Ltd. v IRC; Eilbeck (Inspector of Taxes) v Rawling**[31], have now developed a concept of purposive interpretation, rejecting the old view that taxing statutes are immune from the ordinary principles of statutory interpretation. Pursuant to that modern approach, the court's focus is not on whether the transaction was "genuine" or a "sham", or whether the transaction fell within the literal language of the statute. Rather, the courts now take a "purposive approach" to statutory interpretation and consider whether Parliament could have intended that the particular transaction considered would fall within a liability to tax or an exemption from tax, as the case may be. Counsel for the Respondent cited the House of Lords case **I.R.C v McGuckian**[32] where it was held:

[30] [1936] AC 1; [1935]All E.R. 259 HL
[31] [1981] 1 All ER 865; [1982] AC 300
[32] [1997] 3 All ER 817

> In construing tax legislation, the statutory provisions were to be applied to the substance of the transaction, disregarding artificial steps in the composite transaction or series of transactions inserted only for the purposes of seeking to obtain a tax advantage. Once the artificial steps inserted with that purpose had been identified and disregarded, the language of the taxing statute was to be applied to the transaction carried through after disregarding its artificial steps.

According to this view, the court seeks to ascertain the intention of parliament in order to give it effect. In this regard, it was suggested, the court is not constrained by the literal meaning of the words of the statute if it does not appear to meet that intention.

Counsel for the Revenue also cited the dicta in **Barclay's Mercantile Business Finance Limited** v **Mawson.**[33] The court in that case appeared, however, to retreat from a principle of a more aggressive theory of statutory construction first applied in **Ramsay (W.T) Ltd. v IRC; Eilbeck (Inspector of Taxes) v Rawling**[34]. However, the court pointed out that despite the views of the tax bar, in particular, that some new theory of statutory interpretation had been introduced by Ramsay, this was not the case.

> "The question was always whether the relevant provision of the statute, upon its true construction, applied to the facts as found, and the simplicity of that question showed that the Ramsay case had not introduced a new doctrine operating within the special field of revenue statutes The view that, in the application of any taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded, went too far"[35].

At page 108 of the judgment of their lordships, it was stated:

> The Ramsay case liberated the construction of revenue statutes from being both literal and blinkered. It is worth quoting two passages from the influential speech of Lord Wilberforce. First, (at page 871 and 323 of the respective reports) on the general approach to construction:

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[33] [2005] 1 All ER 97
[34] [1981] 1 All ER 865; [1982] AC 300
[35] At page 98

> What are "clear words" is to be ascertained on normal principles; these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act, as a whole, and its purpose may, indeed should, be regarded.

Secondly, ---- on the application of a statutory so construed to a composite transaction;

> It is the task of the court to ascertain the legal nature of any transactions to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions intended to operate as such, it is that series or combination which may be regarded.

Their Lordships continued at page 109 of their joint judgment.

> The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered the statutory description. Of course, this does not mean that the courts have to put their reasoning into straight jackets of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of the statute, upon its true construction, applies to the facts as found. As Lord Nichols of Birkenhead said in **MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd. [2001] UKHL 6 at 8, [2001] 1 All ER 865, [2003] 1 AC 311**:
> "The paramount question is always one of interpretation of the particular statutory provision and it application to the facts of the case".
>
> The simplicity of this question, however difficult it might be to answer on the facts of a particular case, shows that the *Ramsay case did not introduce a new doctrine operating within the special field of revenue statutes. On the contrary, as Lord Steyn observed in McGuckian's case*[36], *it rescued tax law from being 'some island of literal interpretation' and*

[36] See cite above

> *brought it within generally applicable principles.* (My emphasis)

Pursuing this line of cases, Respondent's counsel cited the Privy Council decision in an appeal in a case from this court, a case in which some of the counsel involved in the instant case were also participants. That case was **Carreras Group Limited v. The Stamp Commissioner**.[37] Counsel cited the advice of the Board as given in the judgment of Lord Hoffmann to the following effect:

> A restricted interpretation of the transaction contemplated by [the legislation] would produce the result that exemption from tax could be obtained by a formal step inserted in the transaction for no purpose other than the avoidance of tax. This would not be a rational system of taxation and their Lordships do not accept that it was intended by the legislature."

On the basis of the authorities cited above, it was submitted that:

> "The intention of the legislature is of paramount consideration in construing the provisions of the Act. It cannot be supposed that the legislature intended that a subsidiary company would be permitted to consistently transfer the bulk of its annual profits to its parent company under the guise of such transfers being loans, so as to avoid the incidence of taxation had those funds been distributed as dividends. The intention of the legislature must have been to exclude genuine commercial loans only from the charge to income tax.

The Appellant denies that the Respondent can gain any support for her position from the cases cited immediately above. In particular, Appellant's counsel sought to distinguish the **Carreras** case on the basis of the different facts of that case. Further, Appellant's counsel also relied upon the dicta of the House of Lords in the **Barclays** case which, he said, explained the basis of the decision in **Carreras**, namely, that-

> "In Carreras, the transfer of shares in exchange for a debenture with a view to its redemption a fortnight later was

[37] [2004] W.I.R 64

> not regarded as an exempt transfer in exchange for the debentures but rather as an exchange for money

It was also submitted that the Appellant's case is supported by the decision in **Barclays** where it was held that, though the transactions may appear to be circular, that would not determine its character. I should point out that the Barclays case *did not say*, as Appellant wrongly submitted, that whatever treatment was accorded to a payment in the accounts was determinative of its true character. Appellant's counsel also cited the dicta of Lord Nicholls of Birkenhead in **MacNiven:**

> "The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case"

What clearly emerges from these cases is that there is no substitute for the court closely examining the statutory provisions which are in question to determine what it was that the legislature intended. In this regard, I adopt as a correct statement of principle in this area of statutory construction, the obiter dicta of Ribeiro PJ in **Collector of Stamp Revenue v Arrowtown Assets Ltd (2004) 6 ITLR 454 at 468**, cited in the **Barclays** case at page 110 of the All England Report.

> The driving principle in the Ramsay line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.

The question to be determined here is whether on a proper construction of the words of the Act, it was within the contemplation of the legislature that a subsidiary would transfer, with no tax consequences, virtually all of its profits to its parent company with no commercial benefit either for the subsidiary or its shareholders apart from CGL, all on the premise that the transfers were loans. It would seem to me that, on a purposive interpretation of the provisions, such a conclusion would be unlikely. However, the underlying and fundamental question

which would inform an answer to the question as posed, is whether the statute contemplated "loans" being made in these circumstances. It follows that the Appellant's characterization as "nonsense", of a submission that on a purposive construction of the section, "loan" in section 35 must mean "genuine loan" is illogical and misconceived.

Richard Walter Pty Ltd. v Commissioner of Taxation

One case which was cited by both Appellant and Respondent and which I have found particularly useful, is the Australian case **R Walter Pty. Ltd. v Commissioner of Taxation**. As originally cited, the Appellant referred to the decision at first instance[38] but it will be recalled that I brought to the attention of counsel the existence of a decision of the Full Court of Australian Federal Court[39] when the matter went on appeal. While the Respondent is confident that this case supports the Revenue's position, the Appellant also holds the view that that case provides support for its position. The Appellant relies upon the dictum of the judge at first instance, Tamberlin J. where he stated that "the central feature of a loan transaction is that the parties must intend that the whole of the moneys lent should be repaid". In this case the judge found that "there was never intended to be, nor was there any such obligation created". It is to be noted that one of the main reasons for the learned judge coming to the decision which he reached, was that he did not believe the evidence of the only witness called by the taxpayer. In any event, as I believe a detailed reading of this important case will show, whether a payment is to be properly characterized as a loan depends upon the objective factors which the court must consider and not merely upon the evidence of a witness as to whether or not there was an intention to repay. I will accordingly spend some time on looking at this case and in particular, the judgment of Hill J.

According to the headnote,

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[38] 31 ATR 95

[39] No. NG 681 of 1995 FED No. 454/96 Income Tax

> The taxpayer appealed against decisions made by the Commissioner disallowing the applicant's objections lodged against amended assessments of income tax for income years ended 30 June 1981 to 30 June 1984 inclusive, and for the income year ended 30 June 1989. The first four appeals sought to exclude from the assessable income for the year ended 30 June 198, the sum of $2,143,148 and for the three succeeding years the amounts of $1,869,195, $1,645,165 and $3,737,581 respectively. The fifth appeal sought the allowance of a deduction of a bad debt of $188,708 and debt collection expenses of $18,458 for the year ended 30 June 1989.
>
> The appeal concerned arrangements by the taxpayer to distribute income derived from the provision of pathology services. Prior to 1981 receipts were paid to a service company under a service agreement between Dr. Wenkart, trading as Macquarie Pathology Services and Morlea Pathology Services Unit Trust. By a series of transactions in 1981 the Wenkart group was restructured and service fees were directed to an entity known as the Morlea Partnership. The Morlea Partnership was entered into by Iroos Pty. Ltd (95%), which held its interest in the partnership as trustee for the Aurelius Unit Trust, and Aborda Pty. Ltd (5%) which held its interest in the partnership as trustee for the Aborda Trust. The Morlea Professional Services Unit Trust was subsequently represented as determined and all its capital and income to have been distributed by book entry to the partners of the Morlea Partnership

By virtue of series of highly complex transactions and arrangements certain sums of money were transferred to a taxpayer by the Morlea partnership and the Commissioner of Taxation sought to impose liability on the taxpayer on the basis that these sums presented income. The taxpayer sought to resist this characterization of the payments and claimed that the sums presented loans by one party in theses several transactions to the taxpayer and that these were monies which were intended to be repaid. In the course of this judgment, Tamberlin J, stated that he did not believe Mr. Holden, the Accountant who gave evidence on behalf of the taxpayer because he found the evidence of this witness incredible in many respects. In addition to this factor, the judge also stated that it was surprising that the taxpayer called no other witness to support what Mr. Holden had said. Although this would have been sufficient in short to dispose of the matter, the judge went the great lengths to set out a number of criteria which he suggested the court ought to look at in order to determine

whether a transfer of a specific sum is properly to be treated as a loan. He set out nine (9) such principles and it was the submission of the Respondent in this case, that most if not all of those factors are present in the instant case.

I shall for the purposes of this judgment review those criteria to see to what extent they are applicable to the instant case. According to the report of the Richard Walter case in the Federal Court, it was the Commissioner's case that the payments which were recorded as loans in the books of account in both the partnership of which Morlea was said to have been agents and Richard Walter as loans were not what they purported to be. He submitted that the court should hold that the loan arrangements were shams. As pointed out by Lockhart, J the first judge who delivered his judgment in the Federal Court only one witness was called to give evidence on behalf of the taxpayer and that was a Mr. Holden. This gentleman had been employed since 1977 as financial controller and at the time of giving evidence, was the Finance Director of various companies in the group of companies of which Richard Walter formed a part. At relevant times, Mr. Holden had been a director of both Morlea and Richard Walter.

One of the pieces of the evidence given by Mr. Holden was that Richard Walter acted as the financier of the groups of companies. In Mr. Holden's words, "For this purpose the cash position of each company in the group was reviewed daily as were the cash needs of each company in the group and if any company had a significant credit balance with the bank, that money was taken over into the account of the applicant by way of loan and if any company needed additional loans that money was lent by the applicant of the company." It will be recognized that the assertion here is very similar that that being made in the instant case where the transfer of the funds from the appellant to CGL was on the basis that CGL provided a central treasury function to ensure the efficient use and disposal of the funds available to the group.

According to the witness for the taxpayer in Richard Walter, "If the Group as a whole had surplus cash funds, that surplus was invested by the Applicant, either in fixed term deposits with banks or with other financial institutions, to achieve the best available return in the light of the security and terms available. From time to time, if the Group as a whole needed additional funds, then it was the Applicant which made overdraft arrangements or long-term financial arrangements with banks or other financial institutions to secure the necessary working capital for the Group". This bears an uncanny resemblance to what Mr. Mahfood for the Appellant, urged this court to find was the function of CGL in its role as a central treasury. It was this role which was also sought to be highlighted in the statutory declarations of Mrs. Sutherland, Mr. Bryan Young and Mr. Roy Collister It is of more than passing interest therefore to find from the testimony of Mrs. Sutherland that even as the Appellant was transferring huge sums of money amounting to hundreds of millions of dollars, the Appellant was borrowing money from its own bank for which it had to provide security. Nor is there any evidence that CGL provided any security or guarantee in respect of those loans.

I will take the liberty of setting out the criteria which Tamberlin J propounded as matters to be considered in determining whether a payment was in fact a loan or other wise. These criteria were specifically approved by the Full Court in the judgments of Lockhart and Hill (JJ).

According to the judgment of Hill J in the Full Court, Tamberlin J. came to the view that the "loans" from Morlea, as agent for the partnership, were really "shams" In so finding his Honour relied upon a number of factors which he set out. Tamberlin J. was careful to point out that some of them individually might not justify a finding that the loans were a sham. Indeed, as pointed out by Hill J. in the Full Court, "this reservation is clearly correct when regard is had to the factors listed by his Honour". I set out below those criteria and then relate them to the situation which we find in the instant case.

1) The moneys were paid without any written evidence of any agreement or obligation to repay apart from book entries made by accounts staff.
2) There was never any written or oral evidence as to the terms and conditions on which the moneys were said to be lent or repaid other than the year end financial statements which were the product of year end journal entries formulated by Holden, the Group Finance Director, to achieve the most desirable tax consequences.
3) It does not appear that any interest was ever charged, payable, or paid by Richard Walter in respect of these loans. There was no group policy that interest should not be charged on intra-group loans according to the evidence of Holden.
4) It is true that, as the applicant points out, there were book entries to indicate some substantial amounts paid by the applicant to MPS Pty Ltd. However, the net movements from MPS Pty Ltd to the applicant were far greater than the converse. For example, to 30 June 1982, the flow of cash from MPS Pty Ltd to the applicant was $1,538,013 and the movement back according to the entries was $500,954. For year ended 30 June 1983, the movement from MPS Pty Ltd to the applicant was $2,301,649 compared with the converse of $866,421.07. In the year ended 30 June 1984, the cash moving from MPS Pty Ltd was $1,926,591 as compared with the converse of $232,459.47. These movements back do not show, in my opinion, that there was an intention to repay all the moneys channelled to Richard Walter.
5) It was within Holden's unfettered power and discretion to move money around the group as he determined to be appropriate. MPS Pty Ltd was completely controlled by Wenkart and Holden. Holden agreed that the real money, the cash money, stayed with Richard Walter and did not go to Aurelius Commodus. He could give no explanation as to the way in which Aurelius Commodus was going to use the 95% of income of MPS Pty Ltd, except that it was going to exploit it by increasing its capital account. He could give no explanation as to what it would do with the amassed capital from time to time. He agreed that part of the arrangement or agreement was that the money be lent to Richard Walter and this was acceptable to Holden because the cash money stayed with Richard Walter.
6) It was impossible for Richard Walter to repay the amounts distributed by MPS Pty Ltd without liquidating the assets of Richard Walter and the evidence was that there was never any intention or even contemplation of doing this.
7) In 1982 the nature of the liability of Richard Walter to MPS Pty Ltd was unilaterally reclassified by Holden from current liability to non-current liability without any board resolution by Richard Walter or MPS Pty Ltd. This was clearly to the detriment of Aurelius Commodus. It appears that no consideration was given by Holden to the trust obligations in this respect. In cross-examination in relation to this matter, Holden was prepared to say, as an experienced accountant, that he did not know whether a dollar today is worth the same or more in a year's time. That

reflects adversely on the credibility of Holden. In my view this unilateral reclassification was done without any thought for, and contrary to the interests of, the beneficiaries allegedly owning the debt due from Richard Walter.

8) The evidence makes it clear that when MPS Pty Ltd needed funds of any size, it borrowed from external financiers instead of calling for repayment of the loan due by Richard Walter which was interest free. There was no evidence of any attempt or proposal to call for repayment of the loan to Richard Walter.
9) The debt alleged to be due from Richard Walter to MPS Pty Ltd was never repaid, but it appears to have been assigned by a series of 'round robin' artificial paper transactions orchestrated by Richard Walter's legal and accounting tax advisers, none of whom were called in evidence by the applicant. No explanation was proffered for not calling them."

In order to compare the foregoing with the instant case, I now set out below what I are manifestly the parallels between that case and the instant one. Implicit in the following are the findings of fact which this court makes pursuant to section 10(1) of the Judicature (Revenue Court) Act.

1) The 1977 Agreement which permitted CGL to "borrow" from CCJ amounts required from time to time, on condition that Carreras guarantees the repayment of such "loans" at such time and in such manner as the companies may mutually determine[40]. There was no evidence of any such guarantee, neither was there evidence to demonstrate that CGL "required" the "loans". In fact, most of the borrowed funds were used by Carreras for low risk investment purposes only, which yielded no returns for CCJ and were eventually repaid in amounts which had by then been substantially devalued. It is perhaps also passing strange that there is not a single mention in any of the minutes of either the Appellant or CGL over the ten (10) year period 1993 to 2002 of any policy of loans being made to CGL by the Appellant, or a policy of CGL acting as a central treasury on behalf of the group.
2) There was no written or oral evidence as to the terms and conditions on which the monies were said to be lent other than the financial statements

[40] See Clause 13 (c)(i) of the 1977 Agreement

which classified them as "non-current" assets or liabilities as the case may be. There was not even a memorandum acknowledging receipts of the transfers, nor promising to provide guarantees for loan requirements of the Appellant.

3) No interest was ever charged on the "loans" and it was only when the issue of the re0rganization and the subsequent assessment arose, that some interest was paid. The suggestion on the part of the Appellant's counsel that no interest was charged because no royalties were being demanded on the use of CGL's trade marks, must be regarded with some skepticism and seems to be a belated attempt to justify the non-payment of interest, and is, at best, self-serving.
4) Unlike in the Richard Walter case, not even book entries to indicate repayments were made. The first time the issue of repayment came up was when the reorganization became an issue. Mrs. Sutherland noted in paragraph 15 of her Declaration that "*the need to repay the loans first arose when CGL decided to streamline its group operations.* There is not a scintilla of evidence that the question of repayment even was even contemplated, let alone discussed, before this.
5) CGL as a 99.8% shareholder of the Appellant had virtually unlimited power to commandeer the surplus cash held by the Appellant There is no evidence that any explanation was ever given to the Appellant as to how and for what purposes CGL would use the funds transferred, nor why the Appellant would give up the opportunity of investing at least some of the funds for its own purposes.
6) While it is not apparent that CGL would have had to liquidate its assets in order to repay the loans, it is probably instructive that Mrs. Sutherland pointed out that as the person responsible for finance at CGL she made sure to keep the funds invested in high quality and easily realizable securities which indicates that there would, in any event, be a lag between a demand for repayment, if one could ever be made without CGL agreeing, and the time for repayment. To say that the funds were

repayable on demand therefore is not correct. Indeed, neither Mrs. Sutherland nor Mr. Ashenheim said that. They merely said that "it was their understanding" that the money was repayable on demand.

7) Whereas in Richard Walter the transfers were "unilaterally re-classified" from "current" to "non-current" liability, in the instant case, the loans were always classified as "non-current" liabilities or assets as the case may be. As noted by the learned judge in Richard Walter, this has implications for the value of the asset as a non-current liability is not due within twelve months. In an economic climate where the local currency was declining and certainly was in decline in the relevant years, it is clear that the value of the asset (assuming it was a loan or sum "due from parent company") would be less by the time it was repaid, if it ever was. As indicated by His Honour Hill J. the term "non-current assets", is an expression used by accounting convention to convey that loans are not repayable within a year. As experienced accounting professionals, I would certainly expect Mrs. Sutherland and Mr. Linroy Marshall to be conversant with the accounting convention being adverted to, and to understand that in an inflationary situation, to treat a loan as a "non-current" asset meant that it was clearly to the detriment of the "lender". It is also worth noting that, in the Richard Walter case, it was the witness Holden's failure to acknowledge the clear implications that reclassifying the loans from "current" to "non-current" assets had for the lender that provided one of the main bases for the learned judge doubting his credibility and dismissing him as not being a credible witness.

8) There is in the case at Bar clear and direct evidence that when the Appellant needed funds it had to go to its bankers to borrow and bear the costs of interest and other charges at the same time it was transferring billions of dollars to its parent company. There was also evidence that the Appellant lent funds directly to other subsidiaries of CGL. It is difficult to make this unchallenged evidence square with the determined protestations of the Appellant through its witnesses that the main reason

for the transfer of the funds to CGL was to serve the "commercial purpose' of having a central treasury which would oversee the efficient use of the group's resources.

9) Finally, there was no repayment of the "debt" or any part thereof until there was need to consider the reorganization of the workings of the group. It was only after this that any money was repaid.

It is true, as Appellant's counsel pointed out, that the judge in the Richard Walter case stated that the essential element of a loan is that there is an intent that the monies advanced is to be repaid. There must be an enforceable obligation to repay on the part of the borrower. It is clear that the learned judge did not say that *any evidence of intention to repay* would be adequate. Rather, having articulated what is the essence of a valid loan, he proceeded to examine the objective factors which he considered necessary to legitimize a claim that an advance was by way of loan. Having looked at the transactions and the factors referred to above, he came to the view that:

> the purported "loans" were simply a false label given in order to mask the real transaction intended by the parties, which was the transfer of the beneficial ownership of the monies to Richard Walter free of any obligation to repay. The nomination of the payments as a loan was calculated to make the true transaction appear as something it was never in truth intended to be.

As a consequence, he found that, as submitted by the Commissioner, the purported loan transactions were "shams" in the sense of the authorities cited. What do the authorities tell us about the meaning of a "sham"?

Some American Cases

I would wish to consider briefly and comment upon some cases, three (3) from the American jurisdiction, which have been referred to by the Appellant and/or Respondent with respect to the treatment of transfers. The Appellant says that these cases were cited before the Respondent and it seeks to rely upon them in this court.

.s mentioned above, the Appellant called in aid of its submission that the transfers were indeed, loans and so not taxable as distributions, the American case of **M.J. Byorick**,[41] a first instance decision, in which the taxpayer succeeded in his contention that advances made to him were genuine loans. It will be recalled that in that case there were clear documentation as well as records of many repayments having been made by the taxpayer. The Respondent's counsel does not disagree with the decision in this case and suggests that it is consistent with its own submission that the objective factors determine whether sums claimed to be loans are, in fact, so. It does not appear to me to advance the Appellant's case.

Appellant also seeks to rely upon **Ralph Crowley v CIR**[42], where the United States Court of Appeals (1st Circuit) ruled in favour of the Revenue and identified factors very similar to those which the court must consider in the present case. The factors included are clearly set out in the judgment. In Crowley, there was a statement to the effect that an enquiry into whether a payment was a loan or a constructive dividend concerned itself with subjective intent rather than objective intent. Nevertheless the court was careful to point out that "*recourse to objective evidence is required to ferret out and corroborate actual intent*". (My emphasis) In that case it was determined that the evidence adduced supported the Tax Court's determination that a "closely held corporation's distribution to a shareholder constituted a constructive dividend rather than loans for income tax purposes. The privilege to withdraw money from the corporation was unrestricted; there was no documentary evidence that shareholder withdrawals were *bona fide* loan transactions; much of the loan reduction was accomplished by artificially crediting shareholder bonuses to his loan account and interest was not paid on loans until *after the Internal Revenue Service began a tax audit of the corporation*".

[41] See page 34 above
[42] 962 F.2d 1077

George R. Tollefsen v CIR[43] is another decision of the United States Court of Appeals (the 2nd Circuit) cited by the Appellant in which the court ruled in favour of the Revenue and relied on facts which are similar to those of the present case. The court said, per Judge Raum:

> "In this case the sole issue was whether or not withdrawals made by Mr. Tollefsen from Tollefsen Manufacturing during 1961, constituted loans, as contended by the petitioners or distribution of dividends, as contended by the Commissioner. Resolution of this issue requires us to determine first, whether Tollefsen's withdrawals were intended as bona fide loans to him or as permanent withdrawals. If the withdrawals were intended to be permanent, we must first determine whether the petitioner received dividends not-withstanding, they were not record owners of stock in Tollefsen Manufacturing".

The Court indicated that essential to the first inquiry is a determination of whether repayment of the advances were in fact contemplated by the parties *at the time withdrawals were made*. The judge concluded that there was *no such intention at the time the advances were made*. He supports this conclusion by pointing out that as at the date of the hearing, no formal repayments in respect of the advances had been made. Further, the monies advanced had been used by the petitioner entirely for his own benefit. The court also made it clear that the mere fact that the petitioner at all material times had the ability to repay, did not assist him in establishing an intention to repay any loans, a necessary pre-requisite in establishing the legitimacy of the sums being treated as loans.

The case of **Earl Bergersen v CIR**[44] also cited by Appellant is also of some helpfulness in resolving the issues herein. It is to be noted that the taxpayer was also in a stronger position in that case than the Appellant is in the present appeal, for the court suggested that if the taxpayers had merely waited to disburse the moneys advanced until after their move to Puerto Rico, they would have avoided. In **Bergersen** the Court again ruled against the taxpayer in relation to the issue of whether certain payments to the taxpayer by a controlled

[43] 431 F.2d 511
[44] 109 F.3d 56

company were properly to be construed as dividends rather than loans. Again in this case, the learned judges in the United States Court of Appeal for the First Circuit restated the proposition that:

> "The conventional test is to ask whether the time of the withdrawal in question the parties in question intended repayment."

The Court cited the case of Crowley referred to above as authority for this proposition but it is the following comment by the Court that highlights the difficulty which the Appellant has in the instant case, "Explaining that "intent" is difficult to discern, courts regularly resort to objective criteria asking whether the transaction bears the traditional hallmarks of a loan or of a dividend". It should be noted that in this latter case, the taxpayer also was in a stronger position than the Appellant in the instant case as they could have retained the monies in their company until they had changed their residence to Puerto Rico at which time they would have to been able to pay out those sums without any tax consequences. It seems clear on the basis of reasoning that the Court's decision whether a payment has the character of a loan or a constructive dividend will not depend upon whether the taxpayer might have been able to change its characterization by the timing of some event, (e.g. change of residence) but rather upon an examination of the objective criteria at the time the advance is made. As the Court said:

> "The question here, then, is whether the Bergersens could pay out moneys to themselves before moving to Puerto Rico and avoid U.S. income taxes by designating the payments as loans. We think that this ought to depend upon whether, in overall character and context, the payments were more like loans or more like dividends. After all, "intent to repay" is merely a functional test that is usually suitable; but the purpose of the tax law is to tax transactions, not rubrics or labels. Cf. **Helvering v Gregory, 69 F.2d 809, 810 (2d Cir. 1934), aff'd, 293 U.S. 465 (1935)**"

The court also had this to say:

> The loan or dividend issue, which is not uncommon in tax cases involving controlled companies, usually poses the question whether the owner is trying to smuggle earnings out of the company without paying personal

> income tax. A dividend or salary paid to an owner is taxable; a loan, being only a temporary transfer, is not. But if a "loan" by the company to an owner is not intended to be repaid, then allowing that label to control would effectively deprive the government of its tax bite on dividends and salaries.

It seems that this was the reason for Mr. Mahfood urging the concept of "smuggling out of the company" to suggest that this must only be in relation to individuals. However, very little intellectual acumen would be required to realize that it would be a foolish system of taxation which could be defeated merely by inserting a corporate entity where a natural person would have been otherwise taxable.

The final case that which reference was made by the Appellant in this context is the English case, **The Commissioners of Inland Revenue v John Sansom**[45] in that case, the Court came to the view that the loans were in fact genuine loans, although the circumstances were "suspicious". Respondent was of the view and I agree that there is nothing in the judgment of the Court of Appeal which assists the Appellant in this case. I wish, finally, to make some comments in relation to the witnesses in this case and of the evidence being sought to be adduced through them from the purposes of this decision.

Are the transactions in this case "Shams"?

His Honour, Lockhart J in the **Richard Walter** case, in considering the word "sham", quoted from his own judgment in a previous case, **Sharrment Pty Limited v Official Trustee in Bankruptcy (1988) 18 FCR 449**, where he said at 454:

> 'A "sham" is therefore, for the purposes of Australian law, something that is intended to be mistaken for something else or that is not really what it purports to be. It is a spurious imitation, a counterfeit, a disguise or a false front. It is not genuine or true, but something made in imitation of something else or made to appear to be something which it is not. It is something which is false or deceptive.'

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[45] [1921] 2 K.B. 492

He also said that the word "includes a sham which is a disguise or smokescreen for no transaction at all, or a totally false front – surface without substance".

The other judge who was in the majority in Walter, His Honour Hill J., cited the judgment of Diplock L.J. (as he then was) in **Snook v London and West Riding Investments Ltd**[46] where he said:

> I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the Court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. But one thing, I think, is clear in legal principle, morality and the authorities, that for acts or documents to be a 'sham', with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating."

I also note with approval the obiter dicta of Hill J. in the Richard Walter case. Having referred to the definition of sham given by Lockhart, he said:

> I would prefer to define a transaction as being a sham transaction where it involves a common intention between the parties to the apparent transaction that it be a disguise for some other and real transaction or for no transaction at all. In so doing I give effect to the words emphasized in the passage from Diplock LJ.

It seems to me that the parties to the transfers in the instant matter exhibited a common intention that they be seen as loans rather than distributions. I also form the view that but for the decision to reorganize, there would have been no consideration given to the question of repayment at all. I adopt these definitions for the purposes of this case and hold that on the basis of all the objective evidence, the description of these transfers as "loans" constituted a sham. In this sense, they were also artificial within the meaning of section 16 of the Act. In light of this finding of fact, it follows that the transfers were **NOT** loans within the meaning of section 35 and thus the protection afforded in that section to transfers to principal members, does not apply. I also hold, in the alternative, that the

[46] 1967 2 QB 786 at 802

proposition that what parliament intended in the legislation contained in sections 34 and 35 was to prevent "individuals" smuggling money out of the company while allowing the same transfers to companies who were principal members without any tax consequences, is wholly untenable. It would not constitute, as counsel for the Respondent pointed out, citing Lord Hoffmann in Carreras, "a rational system of taxation". In this regard, I also re-affirm what was implicit above, that a purposive construction of the relevant statutory provisions does not support such a conclusion.

Respondent's Conclusion

The Respondent having considered all the circumstances surrounding the transfers of funds between the companies, the failure to repay any of the amounts transferred for more than ten (10) years, the absence of any terms and conditions of repayment, including interest, and the absence of any security on the transfer of such large sums of money, properly came to the view that they were all inconsistent with prudent or usual commercial practice. Moreover, the profits having been passed interest free on to the parent company in this way meant that any possible returns to CCJ on those profits were permanently lost. Those factors suggest that these transfers were not genuine commercial loans. The existence of these factors is particularly relevant where, as here, the Appellant insists that the transfers were based upon the "sound commercial practice" of utilizing CGL in a "central treasury role", for fiscal responsibility and efficient use of cash resources. It is, of course, not to be considered insignificant, that in the Walter case, according to the evidence of the Finance Director, the main role of the taxpayer was to act as the main financier for the group of entities.

Consequences of the above

Having concluded that the transfers were not loans but distributions within section 34, it is clear that on general principles, it is for the taxpayer to show that

the Commissioner's assessment is excessive. As was said by Carey J.A. in **Karl Evans Brown v Commissioner of Income Tax**[47]:

> In my judgment, the matter stands thus: There are two distinct burdens of proof in an appeal to the Revenue Court. There is first, the burden on the appellant to show that the assessment is excessive. This onus is a heavy one because of his duty to make a full disclosure of all his income from whatsoever source. The burden on the Commissioner is the lighter one because in the vast majority of cases, the objector is not claiming that he is not liable to tax; he is challenging quantum. The burden on the Commissioner is evidential. It only arises or shifts to him when the tax-payer on whom the initial burden rests, leads evidence that he is not liable for any tax whatever. The Commissioner's Statement of Case need, therefore, only show that the objector is liable to tax and the amount is assessed on the basis of material he has. Thus, to give two examples which are suggested in **Argosy v. Commissioner of Inland Revenue**[48] (supra), the objector's acquisition of property which he has not returned or books he has not produced or which have been falsified, could constitute the material on which the Commissioner could rely, to show taxpayers prima facie liability to tax.

In this case therefore, having come to the view that the Commissioner had the right to raise the assessment, the taxpayer now has the burden of showing that the assessment is erroneous[49]. The burden is therefore on the taxpayer to prove, on a balance of probabilities, that the Commissioner's assessment is incorrect. Again for the implications of this for this Appellant, I turn to the judgment of Hill J. in the **Richard Walter** case, because, in light of the parallels between the cases, it is so apt:

> These principles work out in the present case in the following way. The Commissioner alleges that the payments from Morlea to Richard Walter are income. In order to show that the assessment is excessive Richard Walter must thus show on the balance of probabilities that the payments are not income. It seeks to do that in the present case by making a case that the payments were loans. If this case is accepted, Richard Walter will---------- be entitled to succeed. In the present case it sought to show the amounts in question were loans through the evidence of Mr. Holden who swore that they were and that the accounts reflecting them

[47] [1989] Revenue Court Appeal 43 of 1986
[48] [1971]15 W.I.R. 502
[49] The word "erroneous" replaced excessive in an amendment to section 76 (2) of the Act in 2002

> were correct. His Honour did not believe Mr. Holden, finding that there was no intention that the loans would be repaid. This being the case, the payments in question were not loans. Whether they had some other character may have relevance to the question of sham, but that can for the moment be put to one side. *It cannot be correct to say that the onus lay upon the Commissioner to establish what the payments in question were. If they were not loans it will be for the taxpayer then to show that they are something else which does not have the character of income. If the taxpayer does not do this it will not have satisfied the onus of showing that the assessment is excessive*. (My emphasis)

It is clear that the Appellant having failed to convince the court that the transfers were in fact loans, would have to prove on a balance of probabilities that the payments were of a character which is not of an income nature (such as being distributions as asserted by the Respondent), and that the assessment is accordingly "excessive" and in that sense, "erroneous". This it has failed to do.

Before moving on to consider briefly the issue of the witnesses and their evidence, I will end this part by making the following comment on a submission by Appellant. This is a summary submission by the Appellant's counsel which appears to show that there was, at bottom, a lack of appreciation for what was at its core, the central issue to be determined. The submission was in the following terms:

> The only proper conclusion on the evidence is that the *motive for the loans was not that of tax avoidance*. The reason is clear; until the recent assessments were issued against CCJ, *all sensible and informed members of the business community and their accountants believed that inter-group lending was not a taxable distribution.* Consequently, no one would have regarded such lending as tax-avoidance. (All emphases mine)

The fact that the motive of the Appellant or its Chairman or Finance Director was not tax avoidance would not change its character. Nor does the fact, if indeed it is (for there is no evidence to this effect), that "all sensible and informed members of the business community and their accountants believed that inter-group

lending was not a taxable distribution", change a transfer that is not a *bona fide* loan into such.

The Witnesses and their evidence: Court's use of Experts and Assessors

One of the pieces of evidence before the court was the expert report of Douglas Kalesnikoff given in support of the Respondent. Counsel for the Appellant takes issue with this evidence and urges the Court to disregard this evidence since, it is claimed, the expert purports to give answers on what Appellant's counsel says is, "a mixed question of fact and law." This view is, respectfully, misconceived as it ignores the provisions of the Civil Procedures Rules 2002 which specifically provides for the Court to make use of expert evidence. It is clear that at the end of the day, the Court must determine the weight, if any, to be accorded to the expert testimony and its legal implications. Clearly the Court is not bound to accept the evidence of the expert merely because he is an expert. However, once there is compliance with the provisions of the Rule 32 of the Civil Procedure Rules (2002), the evidence is admissible, and the court is entitled to consider it. Mr. Kalesnikoff, having been confirmed on an application in April 2006 as an expert in a recognized field of expertise (forensic accounting with special reference to tax audits) is able to give such evidence. He has produced a report in relation to which questions could have been submitted by the Appellant or a request made for him to attend to be cross-examined. Neither option was pursued. It seems to me therefore, that the expert is perfectly entitled to give his opinion as to how the advance in question ought properly to be characterized. "Loan" after all, while having legal implications, is a commercial fact, and it is certainly within the technical competence of an expert in forensic/investigative accounting to say whether the commercial characteristics of a loan are exhibited in a set of transactions. The court may then accord that evidence such weight as it may deserve, in light of the totality of the evidence. (See my written unreported judgment on Expert evidence in the case of **Eagle Merchant Bank & Ors. v Chen Young & Ors.**).

I also need to remind counsel, en passant, that the Judicature (Revenue Court) Act provides in section 9 as follows:

> The Court may, when it thinks fit, obtain the assistance of accountants, actuaries, and other scientific or expert persons, to enable it to determine any matter at issue in any appeal, cause or proceeding, and may allow reasonable fees and expenses to such persons to be taxed as costs in the appeal, cause or proceeding.

While neither the statute nor the Revenue Court Rules specify how the court is to "obtain the assistance", it clearly contemplates the court having access to experts to assist in determining the issues which may come before it. If this view is correct, and I think it is axiomatic, then it clearly is open to the Court, where it has granted permission for an expert report, to have recourse, to the extent that it is necessary and advisable, to such a report. I make this observation in the context of CPR 32.3 which provides in paragraph (1) and (2):

(1) It is the duty of an expert witness to help the court impartially on matters relevant to his or her expertise.

(2) This duty over-rides any obligations to the person by whom he or she is instructed or paid.

In any event, pursuant to the CPR 32.17 the court may appoint an assessor to

(a) assist the court in understanding technical evidence;

(b) provide a written report; or

(c) advise the judge at the trial with regard to evidence of expert witnesses called by the parties.

I advert to these provisions merely to reinforce the proposition that there is a clear recognition both in the Judicature (Revenue Court) Act, as well as the CPR 2002, that this court may benefit from available expert advice or guidance without, it being in any way, a derogation from its role to make legal rulings.

The Statutory Declarations of the Appellant's Witnesses

Permission was given for the statutory declarations given by Appellant's witnesses to be treated as affidavits. In relation to that evidence it is to be noted that in the case of the declarations of Messrs Young, Collister and Macbeath, there can be no suggestion that they were witness of fact in the sense that they could speak from their own knowledge, to the events in question which took place at the Appellant's business, between 1997 and 2007. These declarants make general observations particularly in relation to the statement of the Financial Director, Mrs. Sutherland, that CGL provided central treasury services for the group in order to reduce external borrowings and create efficiencies. However, since this evidence is opinion and none of these persons was designated as an expert by the court, nor does any one of the declarations comply with Rules 32.12 or 32.13 of the CPR, it is clear that their opinion is irrelevant to the essential determinations which this court must make on the character of the transfers.

Although I shall deal with the question of the imposition of penalties by the Commissioner later, I believe that it is appropriate to mention here some submissions of the Appellant which purport to be based upon the statutory declarations filed pursuant to an Order of the court that they be allowed to stand as evidence before this court. The introductory paragraphs of the Appellant's submissions on the question of penalty refer to the affidavit of Mrs. Elizabeth Ann Jones, a leading member of the local tax and accounting profession. It is to be noted that there are some seemingly irreconcilable submissions of the Appellant as to whether the transfers were "distributions". There is one submission which cited Mrs. Jones' statutory declaration as the basis for its being made. It is to the following effect:

> Had the loans assessed as being distributions made by CCJ *been in fact distributions, there would have been a serious breach of the Companies Act since such distributions would have resulted in a return of capital to shareholders*. (Linroy Marshall - paragraph 17 and Elizabeth Ann Jones - paragraph 5)

On the other hand, there is the following submission which seems to me to be in conflict with the previous one.

> To the extent "distributions" were made by CCJ to CGL *out of capital and not from distributable reserves no income tax would have been payable as this would have been a return of some of the capital of CCJ and the return of capital is exempt under the exemptions to section 34(1) (2) of the ITA*. There would therefore be no basis in law for treating such loan transactions as artificial and taxable distributions as no income tax would have been payable thereon. .

There is another interesting submission in the Appellant's written submission to the following effect:

> Further, "distributions" would not have been for the benefit of all shareholders of CCJ but only for the majority shareholder, CGL, which would clearly be a fraud on the minority. (Linroy Marshall - paragraph 18)

I say that this submission is interesting because it is clear that even if the transfers were, in fact, loans, the only ones to have benefited from the Appellant's interest free largesse, was CGL who had use of billions of dollars of the Appellant's surplus cash, while the minority two-tenths of 1% had no such benefit. Secondly, these submissions are all conclusions of law in relation to which, the opinion of the affiants, is irrelevant.

Appellant's submissions also refer to, what is described as, the "overwhelming opinion" of a "distinguished array" of witnesses who express the opinion that the central purpose of the transfers was to facilitate CGL carrying out a "central treasury function" on behalf of the group of companies. Further, that this was in line with the best commercial practice followed by groups of companies locally, regionally and internationally. Whatever the virtues of this "distinguished array", it is clear that as witnesses they must either be witnesses of fact in relation to the issues in this case, or they must be expert witnesses. Mrs. Sutherland and Mr. Ashenheim were truly the only witnesses of fact. Linroy Marshall could only give evidence about how matters were treated in the accounts. However, it is clear from the authorities that how a payment may be characterized in the accounts,

does not determine its true character. Incidentally, there was no evidentiary basis laid for Mrs. Sutherland to give evidence of regional or international practice and so her evidence in that regard carries no weight. To the extent that she or any of the others in the array could give opinion evidence as to such practice, they would have to be expert witnesses, so appointed by the court. They may only be expert witnesses if the court has so determined pursuant to the provisions of the Rule 32 CPR. Any other role for such affiants or makers of statutory declarations is wholly misconceived. In that regard, for the Appellant to suggest that there would be no rational reason for a subsidiary making any distribution of a sum greater than an amount needed by the parent to pay to its shareholders, is to make a submission in vacuo, as there is no evidence as to what is a rational shareholder policy generally or in this particular case. These assertions do nothing to advance the Appellant's case. It is manifest that although the purpose of the central treasury function trumpeted by Mr. Mahfood as the commercial *raison d' etre* for the advances was said to be to reduce external borrowing and allow for the efficient use of resources, it did not do so. CCJ was borrowing $25, million dollars when it was on the same day transferring interest free, $30 million to CGL, its parent company.

In his final submissions from his speaking notes, counsel for the Respondent emphasized the view that the statutory declarations were not evidence for the purposes of the issue in this trial. In response to those comments in the speaking notes, Mr. Mahfood conceded that he was not putting Messrs. Young, Collister and Macbeath forward as expert witnesses However, they were experienced business persons who were able to speak to practices which were in "common usage" The response completely misses the point about expert witness and betrays a lack of appreciation of the central role of the CPR 2002 in the new dispensation. Notwithstanding the wide personal experiences of Young, Collister and Macbeath, they must either be witnesses of fact or expert witnesses. If either is to give evidence of what took place at the Appellant's business between 1997 and 2002, he must speak from his own personal knowledge of those facts.

Otherwise, it is hearsay and not admissible. If they are to give opinion evidence, then they must be expert witnesses and must have been so designated by the court pursuant to an application to the Court under the CPR.

The Imposition of Penalties

The Respondent has imposed penalties at the maximum rate purportedly permitted by the Act, that is 50% of the tax which would have been paid by the taxpayer. The Appellant objects to this imposition and in paragraph 12 of its Notice of Appeal, it sets out its position in the following terms:

> The levying or imposition of the said penalties on the Appellant by the Commissioner of Taxpayer Audit and Assessment on the basis that the Appellant had effected artificial or fictitious transactions in order to avoid the incidence of income tax is unconstitutional, unlawful and void since the vesting of power to impose such penalties in the commissioner is a usurpation of the judicial power and therefore infringes the principle of separation of powers and the fundamental rights of the Appellant to the protection of law and to be tried and punished only by a duly constituted court which rights are guaranteed by sections 13 and 20 of the Constitution of Jamaica. Further The Commissioner did not act fairly and in accordance with natural justice in that she proceeded to impose the penalty without any proper notification thereof to the Appellant or opportunity being offered for it to make representation in respect thereof.

If my understanding is correct, the Appellant's objection to the imposition of penalties is premised on the basis that:

1) it is improper, unfair and unwarranted and unreasonable exercise of the discretion
2) it is unconstitutional being in breach of the principle of separation of powers; and
3) It was in breach of the rules of natural justice in that the taxpayer was not given a chance to be heard in relation to the penalty.

The relevant section of the Act provides as follows:

> Any person required by this Act to deduct tax on the payment by him of any sum and pay or account for the same to the Commissioner of Income Tax shall make the said payment of

tax or render the said account or do both as his duty may require within fourteen days after the end of the calendar month in which the first payment was made whether or not tax was deducted from that payment.

Where a person fails to pay or account for any tax by the date required in subsection (1) then

a) If the tax was in fact deducted by him as required by this Act he shall be treated as if the tax had been increased at the rate of 50% per annum in respect of each day after that date on which his failure continues or;

b) If the tax was not so deducted he shall be treated as if the tax were increased at such rate not exceeding that mentioned in paragraph a) as the Commissioner may direct.

Counsel for the Respondent submitted that the Commissioner is obliged to impose a penalty pursuant to section 41(2)(b) but that she had a discretion in relation to the percentage, being less than 50% at which the penalty was imposed. I shall consider the objections raised to the penalty in reverse order to that set out above.

Breach of Natural Justice

It was submitted by counsel for the Respondent that the Commissioner had issued the Notices of Estimated Assessments for the years 1998-2002 including in each case an increase in the tax payable pursuant to section 41 of the Act. This had been done without giving any intimation to the Appellant that consideration was being given to the imposition of the penalty or the opportunity to respond formally to the increase in the tax directed by the Commissioner pursuant to the section. Accordingly, not having been given an opportunity to respond to the increase, the Commissioner thereby denied the Appellant of a fair hearing prior to its imposition, and this constituted a breach of the Rules of Natural Justice.

The Respondent submits that there are two principles which operate to negative the proposition that there has been a breach of the rules of natural justice, by denying the Appellant the right to be heard. Firstly, it was submitted that it is trite law that the right to a "hearing" does not mean or imply that the hearing has to be oral. An ability to be heard in writing is sufficient. Thus, counsel for the Appellant cited the case of **Nyoka Segree v Police Service Commission**[50] and the dicta of Panton J.A. at pages 24-25 of that decision. There, the learned judge of appeal had this to say.

> It is surprising that at this stage of our jurisprudential development, it is being thought that to be heard means that the evidence has to be taken viva voce. This court has said on several occasions, for example in respect of disciplinary proceedings such as the instant matter as well in relation to applications for licenses that the right to be heard is not confined or restricted to viva voce hearing. The management of public affairs in this regard would be too hamstrung if all proceedings of this nature had to be viva voce. The unbridled fact is that the appellant was given ample information as to what was being alleged, and was given generous opportunities to respond.

It was also suggested that support for the position is to be found in the recent case of **Century National Bank and Others v Omar Davies and Others**[51] where Lord Steyn delivering the opinion of the Board, while acknowledging that the right to be heard was a common law principle very much part of the law of both England and Jamaica, reminded of its limitations. As his lordship, citing Lord Reid's judgment in **Wiseman v Borneman**[52] stated:

> Natural justice requires that the procedure before any tribunal which is acting judicially shall be fair in all the circumstances, and I would be sorry to see this fundamental general principle degenerate into a series of hard-and-fast rules. For a long time the courts have, without objection from Parliament, supplemented procedure laid down in legislation where they have found that to be necessary for this purpose. But before this unusual kind of power is exercised it must be clear that the statutory procedure is insufficient to achieve justice and that to require additional steps would not frustrate the apparent purpose of the legislation.

The Privy Council in **Wiseman** went on to hold that in that case, the right of

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[50] SCCA 142 of 2001 (11/03/05

[51] [1999] A.C. 628

[52] [1971] A.C. 298

appeal to the Court of Appeal exercising a wide jurisdiction should be sufficient to achieve justice to the appellants.

The second principle urged by the Respondent's counsel is that the opportunity to be heard does not have to be given before the decision is made as long as it is given before the decision is final. It was suggested that in this case, the statute requires the Commissioner to give the taxpayer an opportunity to object, and the Commissioner must consider the objection before deciding whether to confirm the assessment. The taxpayer has thirty days from the date of service of the assessment within which to object to the assessment[53]. An assessment as notified does not become final and conclusive, unless the taxpayer fails to object within the time limited or until there is a final determination on an objection or an appeal against the assessment[54]. Ultimately, the fact that this issue is being heard here, would seem to support the Respondent's proposition that until the court signs off on it, the penalty is not final. There is therefore, a "statutory procedure", and it was submitted that taken as a whole, that should be sufficient to achieve fairness.

In this regard, in the course of considering this point, I have encountered the case of **Lam Ping Cheung Andrew (Applicant) v The Law Society of Hong Kong (Respondent)**[55] in the High Court of Hong Kong Special Administrative Region, a case dealing with the applicability of natural justice rules to administrative tribunals. Hon. Justice A. Cheong explored at great length the judgments of their lordships in **Wiseman v Borneman** and some other cases. His Lordship in Lam Ping cited Lord Slynn in **Rees v Crane [1994] 2 AC 173, 189E-192G/H**, a Privy Council decision concerning an investigation into a judge's alleged misconduct, in which many earlier decisions – including **Wiseman v Borneman** – were reviewed, and said he found it "most illuminating".

[53] Section 75(4) of the Income Tax Act
[54] Section 75(7) of the Income Tax Act
[55] HCAL 121/2006

This case involved an application for judicial review, pursuant to which the applicant sought to challenge the Council's initial decisions concerning his right to practice as a solicitor, as well as its decision to maintain those decisions despite the applicant's further representations. One of the grounds, relied upon was that there had been a breach of the of the applicant's right to be heard.

He quotes extensively from the learned law lord and I set out the passages in extensu.

Lord Slynn is quoted by the learned judge as saying:

> In most types of investigation there is in the early stages a point at which action of some sort must be taken and must be taken firmly in order to set the wheels of investigation in motion. Natural justice will seldom if ever at that stage demand that the investigator should act judicially in the sense of having to hear both sides. No one's livelihood or reputation at that stage is in danger. But the further the proceedings go and the nearer they get to the imposition of a penal sanction or to damaging someone's reputation or to inflicting financial loss on someone the more necessary it becomes to act judicially, and the greater the importance of observing the maxim audi alteram partem." ...
>
> In ***Wiseman v. Borneman*** **[1971] A.C. 297** the House of Lords held that, where section 28 of the Finance Act 1960 laid down a procedure which enabled the Commissioners of Inland Revenue by a certificate to refer to the tribunal, constituted for the purposes of the section, the question whether there was a prima facie case for proceeding against a taxpayer, natural justice did not require that the taxpayer should have the right to be represented by counsel at the tribunal's determination of that question or to see the commissioner's certificate.
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> Lord Lester of Herne Hill relies on what was said by Lord Reid, at p. 308:
>
> "It is, I think, not entirely irrelevant to have in mind that it is very unusual for there to be a judicial determination of the question whether there is a prima facie case. Every public officer who has to decide whether to prosecute or raise proceedings ought first to decide whether there is a prima facie case, but no one supposes that justice requires that he should first seek the comments of the accused or the defendant on the material before him. So there is nothing inherently unjust in reaching such a decision in the absence of the other party."
>
> Lord Morris of Borth-y-Gest, at pp. 308 and 309, stressed the importance of observing the rules of natural justice. He added, at p. 309: "The principles and procedures are to be applied which, in any particular situation or set of circumstances, are right and just and fair." He continued:
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> "We were referred to many decisions. *I think that it was helpful that we should have been. But ultimately I consider that the decision depends upon whether in the particular circumstances of this case the tribunal acted unfairly so that it could be said that their procedure did not match with what justice demanded*." (Emphasis Mine)

Lord Guest said, at p. 310:

"It is reasonably clear on the authorities that where a statutory tribunal has been set up to decide final questions affecting parties' rights and duties, if the statute is silent upon the question, the courts will imply into the statutory provision a rule that the principles of natural justice should be applied."

Moreover he took the view that a tribunal required to decide a preliminary point, which might affect parties' rights, like a tribunal entrusted with a final decision ought to be required to apply the rules of natural justice. On this latter point, Lord Wilberforce, at p. 317, took a similar approach to that of Lord Guest. *He too stressed that the test was one of fairness in the circumstances*. (Emphasis Mine)

It is clear from the English and Commonwealth decisions which have been cited that there are many situations in which natural justice does not require that a person must be told of the complaints made against him and given a chance to answer them at the particular stage in question. Essential features leading the courts to this conclusion have included the fact that the investigation is purely preliminary, that there will be a full chance adequately to deal with the complaints later, that the making of the inquiry without observing the audi alteram partem maxim is justified by urgency or administrative necessity, that no penalty or serious damage to reputation is inflicted by proceeding to the next stage without such preliminary notice, that the statutory scheme properly construed excludes such a right to know and to reply at the earlier stage.

But in their Lordships' opinion there is no absolute rule to this effect even if there is to be, under the procedure, an opportunity to answer the charges later. As Professor de Smith puts it in de Smith's Judicial Review of Administrative Action, 4th ed. (1980), p. 199:

"Where an act or proposal is only the first step in a sequence of measures which may culminate in a decision detrimental to a person's interests, the courts will generally decline to accede to that person's submission that he is entitled to be heard in opposition to this initial act, particularly if he is entitled to be heard at a later stage." (Emphasis added.)

In considering whether this general practice should be followed the courts should not be bound by rigid rules. It is necessary, as was made clear by Tucker L.J. in Russell v. Duke of Norfolk [1949] 1 All E.R. 109, 118 (as approved by Lord Guest in Wiseman v. Borneman [1971] A.C. 297, 311, and by Lord Morris of Borth-y-Gest in Furnell v. Whangarei High Schools Board [1973] A.C. 660, 679) to have regard to all the circumstances of the case:

"There are, in my view, no words which are of universal application to every kind of inquiry and every kind of domestic tribunal. The requirements of natural justice must depend on the circumstances of the case, the nature of the inquiry, the rules under which the tribunal is acting, the subject matter that is being dealt with, and so forth. Accordingly, I do not derive much assistance from the definitions of natural justice which have been from time to time used, but, whatever standard is adopted, one essential is that the person concerned should have a reasonable opportunity of presenting his case." (All emphases mine)

It seems that the principle which is to be distilled from the foregoing analysis is that the essential question in relation to the right to be heard is the *fairness of the*

procedure and whether the subject of the penalty is prejudiced by the point at which the penalty may be imposed, by his not having been heard at that point. With respect to this concept of fairness and its applicability to these presents, I adopt the following passage from the judgment of Cheong J in the **Lam Ping Cheung** case where he says:

> Counsel's argument reminded me of a well-known passage in Lord Mustill's judgment in ***R v Secretary of State for the Home Department, Ex parte Doody*** **[1994] 1 AC 531, 560D-G**, where his Lordship explained the meaning of fairness, albeit in the context of a statutory administrative power or discretion:
>
> > "What does fairness require in the present case? My Lords, I think it unnecessary to refer by name or to quote from, any of the often-cited authorities in which the courts have explained what is essentially an intuitive judgment. They are far too well known. From them, I derive that (1) where an Act of Parliament confers an administrative power there is a presumption that it will be exercised in a manner which is fair in all the circumstances. (2) The standards of fairness are not immutable. They may change with the passage of time, both in the general and in their application to decisions of a particular type. (3) The principles of fairness are not to be applied by rote identically in every situation. What fairness demands is dependent on the context of the decision, and this is to be taken into account in all its aspects. (4) An essential feature of the context is the statute which creates the discretion, as regards both its language and the shape of the legal and administrative system within which the decision is taken. (5) Fairness will very often require that a person who may be adversely affected by the decision will have an opportunity to make representations on his own behalf either before the decision is taken with a view to producing a favourable result; or after it is taken, with a view to procuring its modification; or both. (6) Since the person affected usually cannot make worthwhile representations without knowing what factors may weigh against his interests fairness will very often require that he is informed of the gist of the case which he has to answer."

I appreciate that this discussion in this case took place within the context of administrative remedies, and the reasoning may not be fully transferable. Nevertheless, if this is a correct approach, It seems to me that, since even as late as the trial in this court on an appeal from the taxpayer it is open to the taxpayer to show that the assessment is erroneous and thereby have it reduced or

discharged, and since in those circumstances the penalty would have to be modified or discharged, then a final determination of the penalty is only effected upon a decision of this court. In any event it seems wrong in fact to say that the Appellant was not advised of an intention to impose a penalty so that it could be heard thereon. For it is clear that the assessments were made including the penalties and the objections and appearances before the Commissioner TAAD and Commissioner Taxpayer Appeals were opportunities at which representations would have been made on both the substantive assessments as well as the penalties. If this view is correct as I believe it is, then this ground as an objection to the imposition of the penalty must fail.

Constitutionality of the Penalty

The Appellant submitted that based upon the authorities, section 41 of the Act is unconstitutional. The Appellant submits that the effect of section 41 is to place in the hands of a non judicial functionary of the executive, the right to exercise judicial functions. This is in breach of the doctrine of the separation of powers which is at the heart of our Westminster system of political arrangements. I am not aware that this point has ever been argued in this court in relation to the Income Tax Act. The Appellant in its submissions notes: "In giving her Reasons for Decision dated February 26, 2004, the Commissioner expressly stated that she had concluded that the amounts in question "were transferred for the exclusive benefit of the parent company as "loans" in order to avoid the incidence of tax". It concludes that: "It is reasonable to infer that the imposition of these harsh penalties was influenced by that conclusion. It is to be noted that this conclusion amounts to a finding of guilt with respect to the additional criminal offence of "falsehood, willful neglect, fraud, covin, art or contrivance whatsoever" contrary to section 72 of the Income Tax Act".

Let me begin by saying that in my view it is incorrect to say that section 41 creates a criminal offence. Nor is there any logical reason for concluding that the

conclusion arrived at "amounts to a finding of guilt with respect to the additional criminal offence of falsehood, willful neglect, fraud, covin, art or contrivance whatsoever" under section 72 of the Act. The authorities cited by the Appellant include **Hinds v The Queen**[56] and **Reginald Deaton v The Attorney General and the Revenue Commissioners**[57], In **Hinds**, the Judicial Committee of the Privy Council clearly held that a review of sentence by a non-judicial body was repugnant to the principle of separation of powers. Similarly, in **Reginald Deaton**, a case under the Irish Customs (Consolidation) Act, it was held that a section of the act which allowed the commissioner of customs to choose which of two penalties should be imposed was in reach of the same principle. In **Browne v The Queen**[58] the Privy Council also held that detention for a period subject to the Governor General's pleasure, implicitly placed in the hands of the executive the role of deciding the sentence of an individual and therefore was the exercise of a judicial function. This position was later affirmed by the Privy Council in **DPP v Mollison**[59].

In **R. v. Wilson**[60], the Jamaican Court of Appeal in the judgment of Martin Wright J.A. opined that the power given under section 210 of the Customs Act to vest in the Commissioner of Customs the right to determine the quantum of the penalties payable for breaches under that section, represented a "denigration of the court to have to bow to the wishes of a non-judicial body". Counsel for the Appellant cited **J. Astaphan & Co. Ltd. v. Comptroller of Customs**[61].to a similar effect, where the Eastern Caribbean Court of Appeal applied the principle laid down in **Hinds** *Case* in holding that a penalty imposed by the Commissioner of Customs for the making of an imperfect entry is inconsistent with the doctrine of separation of powers.

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[56] [1975] 13 J.L.R. 26
[57] [1963 I.R. 170
[58] [2000] AC 45
[59] [2003] 2 AC 411
[60] [1994] 47 W.I.R. 325
[61] [1999] 2.L.R.C. 569

The Appellant also cited **Ranaweera v Wickramasinghe**[62] a Ceylonese Cases by way of seeking to distinguish the result in that case where the Privy Council did not find that the imposition of a penalty in an income tax case compromised the principle of separation of powers. It was submitted that there the case was distinguishable "on the grounds that the basis of the discretion is a mathematical calculation of the difference between the amount returned and the amount of the assessment. In the instant case the basis of the discretion to impose the penalty is a determination that the Appellant had committed the offence of failing to make and account for a deduction which should have been made at source". With respect, it is not correct to say that any "offence" has been committed.

The Respondent in answering these submissions on the question of unconstitutionality and the separation of powers commences with the assertion that courts will normally proceed on the basis that statutes are presumed constitutional and that the burden on the person seeking to prove otherwise, is a heavy one, particularly given the serious consequences that are likely to arise in the event the statute is overturned after it has existed for a long time. Thus counsel for the Respondent cited **Ramesh Dipraj Kumar Mootoo v Attorney-General of Trinidad and Tobago**[63] in which the Board described this burden as "a heavy one". In delivering the opinion of the Board, Sir William Douglas said[64]:

> "It is not in dispute between the parties that in a case involving an Act of Parliament the presumption of constitutionality applies, and that the burden cast on the appellant to prove invalidity is a heavy one".

It is clear that the decision of a court to declare an act of Parliament unconstitutional cannot be arrived at lightly. Conceptually, the authorities say, one starts with the presumption of constitutionality. However, in determining the question, it is necessary for the court to carefully consider the statutory scheme of the enactment[65]. It is not without significance that the decision on the increase

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[62] [1970] AC 491
[63] (1978) 30 WIR 411
[64] At page 415 G
[65] See, e.g., Century National Merchant Bank and others v Omar Davies and Others, [1998] AC 628

of tax is, in my considered opinion, not a matter finally determined by the Commissioner. I have already noted (above in connection with the right to be heard) that since there is an appeal as of right to the Commissioner of Taxpayer Appeals and a further appeal to the Revenue Court, it is that court which will make the order to give effect to any final determination. It would be ludicrous to presume that the hands of this court are in any way constrained by the decision of the Commissioner. Here, as Respondent's submissions correctly point out: "The Appellant has exercised both options. It cannot complain that the statute has allowed the imposition of a discretionary penalty without the opportunity for judicial intervention. It must be noted that this right of appeal is quite different from a right to apply for judicial review, which is what the Appellant would have had in the absence of these provisions".

In **Hinds**, **Deaton** and **Mollison**, critically, the statutory scheme did not include provision for review by a Judge. Moreover, in each of these cases, the court was concerned with a criminal statute and punishment thereunder. As I have said above, section 41 of the Act is not a section contemplating or imposing criminal sanctions. I believe that these provide critical points for distinguishing these cases from the position in the instant case. While there is a certain seductiveness to the proposition on unconstitutionality advanced by Appellant, I do not believe that this court can accept the correctness of the propositions being advanced. Nor do I think I can rely on the authorities cited to support a conclusion that the relevant provision in the Income Tax Act is unconstitutional. I am also not persuaded by the distinction which the Appellant's counsel seeks to make with respect to the **Ranaweera**, a case also cited with approval by the Respondent's attorney. I find this authority very instructive as it is a decision of a very strong board of the Privy Council, including Lord Wilberforce, Lord Diplock, Lord Morris, Lord Donovan and Lord Pearson...

The case was concerned with an income tax provision, section 80 of the Income Tax Ordnance of Ceylon very similar to section 41. The section provides as follows:

80. (1) Where in an assessment made in respect of any person the amount of income assessed exceeds that specified as his income in his return and the assessment is final and conclusive under section 79, the Commissioner may, unless that person proves to the satisfaction of the Commissioner that there is no fraud or wilful neglect involved in the disclosure of income made by that person in his return, in writing order that person to pay as a penalty for making an incorrect return a sum not exceeding two thousand rupees and a sum equal to twice the tax on the amount of the excess.

The headnote is in the following terms.

The only question for decision in the present appeal was whether the Commissioner of Inland Revenue had power to impose penalties under section 80 of the Income Tax Ordinance. It was argued on behalf of the appellant (a taxpayer) that such imposition was an exercise of a power which is judicial and not administrative, and that judicial power could, under the Constitution of Ceylon, be exercised only by a judicial officer appointed by the Judicial Service Commission. In support of the submission that the Commissioner exercised judicial power, reliance was placed on the words " unless that person proves to the satisfaction of the Commissioner " in section 80 and upon the alternative course which the Commissioner could elect by causing proceedings to be instituted before a Magistrate under sections 90 and 92 of the Income Tax Ordinance.

Held, that where the resolution of disputes by some Executive Officer can be properly regarded as being part of the execution of some wider administrative function entrusted to him, then he should be regarded as still acting in an administrative capacity, and not as performing some different and judicial function. This is particularly so in the field of income tax though it is certainly not confined thereto. The Commissioner, when he acts under section 80 of the Income Tax Ordinance, is still performing his administrative duties albeit that he must act judicially in exercising the powers conferred upon him by the section. The conclusion that this is not the same thing as the exercise of judicial power is unaffected by the circumstance that penalties may be imposed as an alternative by a Magistrate acting under sections 90-92 of the Income Tax Ordinance,

I set out below some quotes from the speech of Lord Donovan who delivered the opinion of the Board. I should note that by the time the matter came to the Privy Council, the taxpayer who had also argued that he had been denied natural justice because of a failure to provide him with an opportunity to be heard, as does the Appellant here, had abandoned that part of his appeal.

The sole ground of appeal is that the Commissioner was not entitled in law to impose penalties under section 80 of the Income Tax Ordinance. It is said that such imposition is an exercise of judicial power that judicial power can, under the Constitution of Ceylon, be exercised only by a judicial officer appointed by the Judicial Service Commission and that the Commissioner is not such an officer.

He also stated:

The taxpayer argues that here, at the very least, the Commissioner is given a power which is judicial and not administrative. He has to make up his mind whether a taxpayer has " proved" the absence of fraud or wilful neglect, which is essentially a judicial function, and one which, when performed leads either to his discharge from all liability for penalties, or the infliction of them upon him. Reliance is also placed upon the provisions of sections 90 and 92 of the Income Tax Ordinance, which provide, as an alternative to proceedings under section 80, a prosecution for making incorrect returns etc. before a Magistrate who can inflict a fine or imprisonment or both. This it is said would clearly be an exercise of judicial power and in essence the Commissioner, if he elects to proceed under section 80 instead, exercises the same kind of power.

The problem thus posed has confronted Courts in a number of countries, particularly those with written constitutions embodying a separation of powers. In those countries, as in the United Kingdom, Government agencies have been created for the discharge of some particular function, and for the task thus imposed upon them Executive Officers have been necessarily entrusted with the resolution of differences which may arise between the subject and the particular agency in the course of the agency's work. *This is particularly so in the field of income tax though it is certainly not confined thereto. Accordingly officers appointed by the Executive may find themselves hearing evidence, weighing it, testing it, and coming to a conclusion upon it: and all the time having to do their best to be fair and impartial, In a word they have to act judicially. Yet in ordinary everyday language they would not be called "Judges" or "members of the Judiciary " or "holders of judicial office". What is it then which distinguishes them from those who do hold and exercise such an office, seeing that the nature of the task which these Executive Officers have to perform and the qualities they must bring to bear upon it correspond on such occasions so closely, if not exactly, with the exercise of his office by a judge? The answer which has generally been given is that where the resolution of disputes by some Executive Officer can be properly regarded as being part of the execution of some wider administrative function entrusted to him, then he should be regarded as still acting in an administrative capacity, and not as performing some different and judicial function.* (My emphasis)

His lordship then cited some American decisions which lend support to the principles which he suggested guided the decision to which reached in **Ranaweera**. He also referred to an Australian case **Shell Company of Australia Ltd, v the Federal Commissioner of Taxation for Australia**[66] where a similar situation had been considered. He said:

> In an earlier case the Company, then known as British Imperial Oil Company, had successfully contended that a Board of Appeal created under the Australian Income Tax Assessment Act of 1922 to consider income tax appeals, exercised part of the judicial power of the Commonwealth contrary to sections 71 and 72 of the Constitution of Australia. Not being established in accordance with these provisions the Board of Appeal was invalidly constituted and its decisions were of no effect. This ruling was given by the High Court of Australia and it was not appealed against. Instead, an amending Federal Statute was passed abolishing the Board of Appeal. A new Board was created called the Board of Review and its constitution was altered so that it not merely heard income tax appeals but its powers were closely equated with those of the Commissioner of Taxes himself. The Shell Company nevertheless objected to the Board of Review contending that it also exercised judicial power and was therefore as invalid as had been the superseded Board of Appeal. The High Court of Australia rejected that contention, and its decision was upheld by their Lordships on appeal. The following extracts from the judgment delivered by Lord Sankey may be quoted
>
> "The authorities are clear to show that there are tribunals with many of the trappings of a Court which, nevertheless, are not Courts in the strict sense of exercising judicial power. It is conceded in the present case that the Commissioner himself exercised no judicial power. The exercise of such power in connection with an assessment commenced, it was said, with the Board of Review, which was in truth a Court.
>
> In that connection it may be useful to enumerate some negative propositions on this subject:
>
> 1. A tribunal is not necessarily a Court in this strict sense because it gives a final decision. 2. Nor because it hears witnesses on oath. 3. Nor because two or more contending parties appear before it between whom it has to decide. 4. Nor because it gives decisions which affect the rights of subjects. 5. Nor because there is an appeal to a Court. 6. Nor because it is a body to which a matter is referred by another body. See Rex v. Electricity Commissioners (1924) 1 K. B. 171.

[66] [1931] AC 276

> Their Lordships are of opinion that it is not impossible under the Australian Constitution for Parliament to provide that the fixing of assessments shall rest with an administrative officer, subject to review, if the taxpayer prefers, either by another administrative body, or by a Court strictly so called, or, to put it more briefly, to say to the taxpayer ' If you want to have the assessment reviewed judicially, go to the Court. If you want to have it reviewed by business men, go to the Board of Review.' "(pp. 296-7).
>
> "An administrative tribunal may act judicially, but still remain an administrative tribunal as distinguished from a Court, strictly so-called. Mere externals do not make a direction to an administrative officer by an ad hoc tribunal an exercise by a Court of judicial power.
>
> Their Lordships find themselves in agreement with Isaacs J., where he says : 'There are many functions which are either inconsistent with strict judicial action ... or are consistent with either strict judicial or executive action ... If consistent with either strictly judicial or executive action, the matter must be examined further . . . The decisions of the Board of Review may very appropriately be designated ..." administrative awards ", but they are by no means of the character of decisions of the Judicature of the Commonwealth.' They agree with him also when he says that ' unless ... it becomes clear beyond reasonable doubt that the legislation in question transgresses the limits laid down by the organic law of the Constitution, it must be allowed to stand as the true expression of the national will.' In that view they have come to the conclusion that the legislation in this case does not transgress the limits laid down by the Constitution, because the Board of Review are not exercising judicial powers, but are merely in the same position as the Commissioner himself-namely, they are another administrative tribunal which is reviewing the determination of the Commissioner who admittedly is not judicial, but executive."

I respectfully adopt the views expressed by the learned law lord, as well as the views of the learned, Lord Sankey, whom he cited. I do not agree with counsel for the Appellant that this case was impliedly overruled by **Hinds**. Nor do I consider that anything turns upon the fact that Deaton was not referred to in the appeal. I am satisfied that this is a correct statement of the law. Further, it is also worth bearing in mind that in the Ranaweera case, the Privy Council at the same hearing had to rule upon a challenge to the Ceylonese equivalent to the Commissioner of Taxpayer Appeals, a challenge which also failed.

On the other hand, I also note the observation from the Respondent's counsel

that there are provisions of the United Kingdom Taxes Management Act which are *in pari materia* with the provisions in the Act. Thus for example, section 100 of the Taxes Management Act of 1970 provides as follows.

> *(1)* Subject to subsection (2) below and except where proceedings for a penalty have been instituted under section 100D below.... An officer of the Board authorized by the Board for the purposes of this section may *make a determination imposing a penalty under any provision of the Taxes Acts and setting it at such amount as, in his opinion, is correct or appropriate*. (My emphasis)
>
> (2) Subsection (1) does not apply where the penalty is a penalty under:
>
> a. Section 93(1) above as it has effect before the amendments were made by section 162 of the Finance Act 1989 or section 93(1) (a) above as it has effect after those amendments,
>
> b. Section 94(1) above as it has effect before the substitution made by section 83 of the Finance Act (No 2) 1987....."

It is clear that under the Taxes Management Act, the discretion to impose a penalty as well as to determine the amount of that penalty is virtually untrammeled and, *ex hypothesi*, requires a member of the Board of the Commissioners of Inland Revenue to make determinations which necessarily require the exercise of a judicial capability, albeit in the context of its administrative functions. There can be no gainsaying the proposition that the powers under the Taxes Management Act are considerably wider than those given to the Commissioner in our Act. They give members of the Board of Commissioners the right to impose penalties up to a certain limit, subject to review by the Commissioners and the High Court. There has not been, as far as I am aware, any complaint about separation of powers in relation thereto. I am of the considered view that this is because those provisions do not contravene the principle of separation of powers and that is because the statutory scheme taken as a whole, allows for a review of the decision by a judicial officer. The lack of any challenge to this provision and the logic of Ranaweera seem, to me, to be a

complete answer to the submission of the Appellant, based particularly upon the reasoning in Deaton, that whereas the prescription by statute of a specific penalty does not involve the person imposing that penalty in any judicial function, where the functionary has discretion to determine the extent of the penalty within a range, this necessarily involves the exercise of a judicial function by one who is not a member of the judiciary. I accept the Respondent's submission that the provision in section 41 of the Act, and the Commissioner's acting on it, are similarly not in breach of the principle of separation of powers and accordingly, not unconstitutional.

Improper, unfair, unwarranted and unreasonable exercise of Discretion

It will be recalled that in giving her decision as to why she had raised the assessment, the Respondent had pointed out that she had concluded that the amounts in question "were transferred for the exclusive benefit of the parent company as "loans" in order to avoid the incidence of tax". She had arrived at that conclusion based upon the history of transfers over a ten year period and the fact that despite the Appellant claiming the transfers to have been loans, Appellant was unable to adduce any evidence of any indication of an intention to repay the sums in question, prior to the raising of the assessment. It is, perhaps, not unreasonable for the Respondent to have concluded as she did given the fact that it is only the evidence of two of CGL's main operatives, its chairman and its Finance Director, *ex post facto*, that speaks to this intention. Indeed, there can be no argument that can be made with any credibility that any of the benefits of the huge profits generated by the Appellant accrued to anyone else apart from its parent company.

The question may well be asked: "In light of the total lack of benefits flowing to the Appellant, and the total lack of any accountability to it as to the appropriation of those funds, can there be any doubt that for all practical purposes, CGL treated the money as being beneficially owned? What would be the position if the investments made by CGL from the transfers, (and one understands from Mrs.

Sutherland's evidence that they were put in investments which were easily realizable), had failed and led to a loss of the sums so invested?

Counsel for the Respondent submitted that the Commissioner is obliged by section 41(2)(b) of the Act to increase the tax payable by a person required to deduct tax on the payment by him of any sum and who has failed to pay or account (as the case may be) for that tax. It was submitted that the discretion related only to the rate by which the said tax should be increased. It would seem that that is a correct reading of the provision. Paragraph (a) of section 41(2), where the tax has been deducted but not paid over or accounted for, makes the imposition of the 50% per annum penalty as mandatory. Paragraph (b) of that subsection clearly contemplates that the Commissioner will have flexibility in setting the rate of penalty where the tax has not been deducted.

Having said all of that I still believe that it is for the court to make a determination as to whether the imposition of the penalty at the rates imposed is fair. Many would say that there is no equity in a taxing statute and to the extent that the statute allows the Commissioner to impose a penalty up to the rate of 50%, then that is her right. But such a conclusion would fly in the face of the submission by the Respondent's own counsel when he points out, in the argument as to the constitutionality of the penalty, that the charge is subject to review by this Court. I confess a lingering uneasiness with fact that the taxpayer did in fact file returns for the period in question. Given that fact, the Commissioner would have been aware, or ought to have been aware, of the existence of these significant transfers and yet did not raise any questions until the issue of the reorganization was raised.

I believe that in the context of reviewing the appropriateness of the imposition and the rate of the penalty, this Court is required to consider principles of fairness. In my discussion above on the submission that the penalty should be struck down because of the failure to allow a right to be heard, I stated that that

discussion had to be placed in the context of "fairness". There I took the view that there was no failure to allow a right to be heard and no concomitant unfairness on that account. On the other hand, I do believe that since the Commissioner had an opportunity to have raised the issue of the transfers at an earlier date and this would have obviated the belated assessments for the period going back to 1997, the imposition of the maximum penalty is unfair. In this regard, I return to the words of Lord Mustill cited to by Cheong J in **Lam Ping Cheung** at page 82 above:

> What does fairness require in the present case? My Lords, I think it unnecessary to refer by name or to quote from, any of the often-cited authorities in which the courts have explained what is essentially an intuitive judgment.

Intuitively, I believe that the imposition of the full penalty in the instant case is unfair and unreasonable. However, as I said in an earlier case, **Paul Desnoes v Commissioner of Taxpayer Appeals**[67], I do not easily come to the view that I should substitute my own discretion for that of the Commissioner. Nevertheless, I would be inclined to the view that a much more liberal penalty, if any, should be exacted and I would remit the matter of the penalty to the Commissioner, for re-consideration, with a recommendation that the Commissioner impose either a nil penalty or nominal one in an amount not exceeding 5% of the total tax payable.

In view of the considerable length of this judgment, for which I apologize, and also in order to ensure clarity on the findings of fact, I summarize below those findings which this Court has made in relation to this issue. These were set out above in the section of the judgment where I dealt with a comparison between the **Richard Walter** case and the instant case at bar. However, for clarity I restate, seriatim, below those findings of fact.

1. The1977 agreement pursuant to which the funds were transferred according to the Appellant, allowed the parent company CGL to borrow such amounts "as required" and "on condition that Carreras guarantees the repayment of such loans at such time and in such manner as the

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companies may mutually determine." There is no indication that the amounts which were borrowed were "required" by CGL, nor is there any evidence that CGL guaranteed the repayments.

2. There is no mention in any of the minutes either of the Appellant or of CGL over the ten year period from 1993 to 2002, of any policy with respect to "loans" being made to CGL by the Appellant or that CGL was to act in a "central treasury" role on behalf of the group.
3. There is no written or oral evidence as the terms or conditions on which the monies were said to have been lent other than the financial statements of both companies where they were classified as "non-current assets" or "non-current liabilities" as the case may be.
4. No interest was charged or paid on the purported loans until the issue of the reorganization arose and the subsequent assessment was issued.
5. There is no objective reliable and independent evidence for the view expressed in the statutory declarations that the decision not to charge interest on the loans was in consideration of the Appellant not paying royalties for the use of CGL's trade marks.
6. Mrs. Sutherland confirmed that as far as she was aware, no quantification was ever done as to the interest foregone by the Appellant or the royalties purportedly foregone by CGL.
7. There were no repayments of any sums transferred to CGL prior to the question the reorganization and the raising of the appropriate assessment.
8. CGL, as a 99.8% shareholder had virtually unlimited power as a matter of fact and law, to determine what was to be done with surplus cash held by the Appellant. There is no evidence that any explanation was ever given to the Appellant as to how CGL proposed to use the funds in question.
9. There was no evidence apart, from the views expressed by both Mr. Ashenheim and Mrs. Sutherland as their "understanding", that the sums were repayable on demand. In any event, I find that this would be inconsistent with the characterization in the accounts as "non-current assets" and "non-current liabilities".

10. There is clear evidence that the funds were not transferred to CGL in order to fulfill a central treasury role and to "reduce external borrowing". There is no evidence that external borrowing was in fact reduced or that CGL financed any of the other subsidiaries. In fact, there is direct evidence that in at least one case, on the very day that sums were being transferred to CGL, the Appellant was arranging to borrow a lesser sum on which it would pay interest and charges from its bankers, the Bank of Nova Scotia.

In light of the above findings, this court also finds that the transfers were not genuine "loans" within the provisions of Section 35 of the Act and so do not attract any protection afforded to such genuine loans. I hold that they were distributions within the meaning of Section 34. These holdings are sufficient to dispose of the matter. However, if it were necessary, I would also be prepared to hold that the transactions were artificial within the meaning of section 16 of the Act.

Accordingly, the appeal of the Appellant against the assessments is dismissed. The assessments are confirmed subject to what I have said about the penalties above. The issue of the penalties which have been imposed by the Commissioner is to be remitted for further consideration in accordance with the recommendations of this Court, set out above.

Costs of this appeal are to be the Respondent's, to be taxed if not agreed.

Anderson J
Judge of the Revenue Court
October 31, 2007.