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INCOME TAX APPEAL

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Jamaica

No. 6 of 1972

In the Revenue Court - On 16th January, 1973 and on 12th April, 1973

BETWEEN

Anthony Michael Thwaites - Appellant

AND

The Commissioner of Income Tax - Respondent

For the Appellant : Richard Mahfood, Q.C.

For the Respondent : [illegible] A. H[illegible]-Phillips.

This is an appeal against a Decision of the Respondent dated 19th April, 1972, in which the chargeable income of the Appellant for the Year of Assessment 1966 was fixed at $6,414 and that for the Year of Assessment 1969 was fixed at $7,960.

The facts are not in dispute, and are briefly as follows.

In the year 1960 the Appellant purchased on credit from his mother, $20,000 worth of shares in a company which was later amalgamated with another company, into a new company, known as Dyoll Insurance Company Limited, and of which the Appellant is now Managing Director. The terms governing the purchase required the Appellant to pay a certain amount each year, by way of interest on any unpaid purchase money outstanding in respect of the shares, which were pledged as security for the debt. In each of the years of assessment beginning with 1961 and ending with 1969, an amount was paid by the Appellant to his mother by way of interest on the unpaid purchase money. In each of those years, except the Years of Assessment 1966 and 1969 (the years now in dispute) the Appellant also received an income by way of dividends from the shares and was allowed to treat the interest so paid as a deduction in arriving at his chargeable income, pursuant to

Section .../

Section 8(1)(a) of the Income Tax Law 1954. He had no other shares in any other company.

During the Years of Assessment 1966 and 1969, the Appellant, as I have already indicated, received no income from the shares, his total income for those two years consisting solely of emoluments received in respect of his employment as Managing Director of Dyoll Insurance Company Limited. In his tax returns for those two years, however, he nevertheless treated the interest payments as expenses deductible under the aforesaid Section 8(1)(a) as having been wholly and exclusively incurred in acquiring his income. The amount for 1966 was $2,000 and that for 1969 was $1,500.

The Appellant's claim to have them so treated was, however, rejected by the Respondent, on the ground that such payments were not properly allowable under Section 8(1)(a), as the interest had not been paid on any capital employed by him in acquiring his income for the years of assessment 1966 and 1969. The Appellant in due course appealed to this Court, and contended before me that he was entitled to the deductions claimed, whether or not any dividends had been received by him from the shares, during the relevant periods.

The question therefore which this appeal raises is whether the Appellant is entitled to a deduction under Section 8(1)(a) of the Income Tax Law 1954, in the circumstances outlined above.

Section 8(1), so far as is relevant, provides as follows:-

> "8 (1) For the purpose of ascertaining the chargeable income of any person, there shall be deducted all disbursements and expenses wholly and exclusively incurred by such person in acquiring the income -
>
> (i) where the income arises from emoluments specified in paragraph (c) of section 5 of this Law, during the year of

assessment .../

assessment; and

(ii) where the income arises from any other source, during such time as is provided for in section 6 of this Law,

and such disbursements and expenses may include -

(a) any sum paid by such person by way of interest upon any money borrowed by him where the Commissioner is satisfied that the interest was paid on capital employed in acquiring the income:

Provided that -

(1) the interest is paid to a person resident in this Island; or

(2) the interest is paid to a person resident elsewhere than in this Island, and that either -

(i) no tax is required to be deducted from the interest or such tax as is required by this Law to be deducted has been deducted from the interest and has been accounted for to the Commissioner; or

(ii) there is in the Island some person who can be assessed in respect of the interest, or who is liable to pay the tax chargeable upon the interest."

Chargeable Income is defined at Section 2 of the ~~Law~~ Act as follows:-

"'chargeable income' means the aggregate amount of income of any person from all sources remaining after allowing the appropriate deductions and exemptions under this ~~Law~~ Act."

From what has been said so far, it is clear firstly, that a deduction for interest paid, under paragraph (a) supra, is only allowable where it can be shown inter alia, that the

same .../

same has been - "paid on capital employed in acquiring the income"; and secondly, that on the uncontested facts of this case, the capital to which the interest payments related produced no income during the two accounting periods relevant to this appeal; a situation which, prima facie, suggests that the Appellant's claim for the deduction was correctly refused by the Respondent.

Counsel for the Appellant, however, put the case this way. He submitted:-

(1) that the expression "the income" used in paragraph (a) was not intended as a reference to the income acquired from Dividends but was intended as a reference to "the chargeable income", arising in a particular year;

(2) that inherent in the definition of chargeable income set out in Section 2 of the Law, was a concept of aggregation which entitled a taxpayer to aggregate, not only his income from all sources for the year, but his expenditure as well;

(3) if therefore, there was some chargeable income arising in a particular year, the taxpayer was entitled to aggregate and deduct all items of expenditure listed in Section 8, which he had incurred for that year, whether or not the same could be related to an asset which had actually produced income in the year. It was sufficient, Counsel submitted, simply to show that the expenditure had been incurred on "an income producing asset"; as, for example, was the case under paragraph (e) of the section, in which it was sufficient

to show ../

to show that the amount claimed had been incurred "for the purposes of a trade or business" carried on by the taxpayer.

(4) there was, he said no compelling reason why the deduction under paragraph (a) should be placed on any different footing from that under paragraph (e), since all deductions under Section 8 were based on the same basic principle relating to the ascertainment of taxable income, which is to be found in such cases as Vallambrosa Rubber Company Limited v. Farmer reported at p. 529 of Volume 5 of the Tax Cases;

(5) since therefore the expenditure had been incurred by the Appellant on an "income producing asset" during years of assessment in which he had a chargeable income, it should be allowed in the terms claimed.

I accept that in a case where the source of a taxpayer's income is a trade or business, and there is some income accruing from that source during a year, it would be unlawful to restrict his deductible expenditure merely to what had been expended on those assets alone which had produced an income for the year. That was in one sense, the effect of the decision in the Vallambr case, where a company was held to be entitled to deduct expenditure on rubber trees which had not yet matured and had not therefore produced any income in the trade being carried on by the company. It must be remembered, however, that in the Vallambrosa case the source of the company's income was a trade, namely that of producing and selling rubber, and some of the trees had in fact produced an income in respect of that

trade .../

trade during the relevant period. It would seem therefore that another way of looking at that case is to say that it establishes that when there is income accruing from a particular source in a year, all revenue expenditure attributable to that source may be allowed as a deduction, even if some of that expenditure relates to assets which did not in fact produce any income in the year.

However, in the instant case, the only source of income accruing to the Appellant during the Years of Assessment 1966 and 1969, was his emoluments from his employment as Managing Director of the Dyoll Insurance Company Limited. In other words, unlike the Vallambrosa case, the source to which the expenditure related, namely dividends, produced no income whatever during the relevant period, and it is that factor which has given rise to the problem in this Appeal, because the Appellant is, in effect, claiming a deduction in respect of a source of income which was sterile during the years to which his claim relates.

In order to deal properly with the contentions put forward in support of that claim it will, I am afraid, be necessary to say something about the underlying basis upon which a taxpayer's chargeable income for each year is ascertained.

First of all, although the statute nowhere defines income it sets out at section 5, the various sources of income upon which the tax is levied. Such sources include, inter alia, income from trades, professions, rents, interests, dividends, emoluments and so on. Section 5 is the charging section, and the result of this is that if in any given year of assessment a person is in receipt of income from one or more of those sources he falls within the purview of the statute, and is (deemed) liable to be assessed in respect thereof. That assessment, however, must be made with particular reference to section 8, and to the definition of "chargeable income" provided in section 2, and when that is done, what emerges is that the taxable element of the incomes accruing from the various sources in section 5, is not the gross

amount .../

amount accruing, but rather the net gain or benefit in each case to the taxpayer. In other words, the process of assessment laid down by the statute embodies a concept well known to the commercial world, which is, that income in its most exact sense, is not a gross, but a net figure, or as it has been put on more than one occasion - it is gross receipts less the cost of earning them. Thus, if a man spends $200 in a year in order to earn $1,000, his true income, is not $1,000, but in fact only $800 - which figure represents of course his net or true gain - or as I have said, his gross receipts less the cost of earning them. This concept is fundamental to the law of Income Tax, and Section 8(1) of the Jamaican Statute, which expressly allows as a deduction in arriving at chargeable income - "all disbursements and expenses wholly and exclusively incurred in acquiring the income", is simply that concept reduced to statutory language. The tax therefore is levied on the net or true gain and the process of assessment is designed to produce that result, which when obtained, is known as the Chargeable Income.

However, because of the division of income into sources, this concept of searching for the true or net income, is applied in turn to <u>each separate source</u> of income set out in Section 5, from which an income accrues in a given year. Thus, where the source is a trade all deductions appropriate to that source are to be allowed so as to establish the taxable quantum of income from that source. Similarly, where the taxpayer also has income from say, rents, then again all deductions appropriate to that source are to be allowed so as to establish the taxable quantum of income therefrom, and so on, down the line to every source which produces an income in the year which is being taxed. At the end of that exercise, the amounts remaining in respect of all such sources (i.e., after allowing the deductions appropriate to each) are then aggregated, and that <u>aggregate</u> sum represents the total

taxable .../

taxable quantum of income for the year, or as the statute describes it, the chargeable income for the year.

In the case of the Appellant, this concept is well illustrated in his computations for those years during which he had an income from two sources, namely dividends and emoluments. The interest payments in those years were appropriate deductions then, because, having had an income from dividends, it became necessary to fix the chargeable amount thereof, and consistent with what I have just said, the method of doing that was to set off against the gross dividends, the cost of earning them; a procedure which in the case of the Appellant meant setting off the amount paid by way of interest on the shares, against his total income from dividends. The amount remaining was then aggregated with an amount similarly obtained in respect of his income from emoluments, and the total, less his appropriate personal allowances, thus constituted his chargeable income for each year.

Such an approach would seem to be a logical result of the division of income into sources, and of the definition of chargeable income set out at section 2 of the Law. I say this because, if chargeable income is - "the aggregate amount of income of any person from all sources remaining after allowing the "appropriate deductions and exemptions under this law" - then, that can only mean that the right to deductions and exemptions is not at large, but is restricted to such of them as may be appropriate".

The question therefore arises - to what must these deductions and exemptions be appropriate? In my opinion, and in the context of a statute which had divided income into separate sources, all of which may not yield income in a given year, the answer is, that they must be appropriate to the sources being taxed in the particular year; which in turn means

those .../

those sources only which produced income in the year, and are for that reason, subject to the charge to tax. This view of the matter seems to me to be consistent with the scheme of the legislation to which I have just been referring, since it is difficult to see to what else the deductions could be appropriate, other than the sources, to which they may relate, or where the taxpayer is an individual, to his personal circumstances as well. If one were to express this concept differently and say, for example, that "appropriate" meant - "appropriate to the year being taxed", that would, in my opinion, fail to give effect to the implications of other provisions of the statute such as paragraph (h) of Section 8(1).

The significance of all this is that it indicates that before a deduction can be allowed in a computation of chargeable income for a year, the source to which it relates must have been caught by the charging provisions of section 5, an event which can only occur of course, in a year in which the source produces income; once that happens then both the source and the income which it produces, become chargeable, and reference must at that stage be made to section 8(1) so as to determine the extent to which the income is chargeable, which in turn means allowing all disbursements or expenses wholly and exclusively incurred in acquiring the same. If, however, no income has been yielded by the source, then nothing has been charged and there will therefore be no need to refer to section 8(1), since to do so would be seeking to determine the chargeable amount of nothing. Where the source is one to which paragraph (h) of the subsection applies (i.e., trades, etc.), there is a slight gloss on the foregoing in that the taxpayer can, in such a case, by the provisions of that paragraph set off his loss, against other income accruing in the same year. If there is no such other income, then he is simply not assessed at all in that year, and he is allowed to carry forward his loss.

If therefore,.../

(If therefore, in the instant case the Appellant's only possible source of income in the two years had been dividends alone, and no income had been yielded from it in both years, there is no question but that he could not have been assessed at all for either year, since, in such circumstances, he would not have had any chargeable income.) What has happened, however, is this - having received an income from emoluments in these years, he does in fact have a chargeable income, and he is, in effect, seeking to have the interest payments treated as a "loss" on his dividend income, which can be set off against his income from emoluments, thereby reducing that chargeable income by the amount of the "loss". In addition to this, of course, the fact is that the capital to which the interest relates was never employed in acquiring his emolument income.

The simple fact is that the Appellant, having failed to receive any income from dividends during the relevant years of assessment, had no taxable entity from that source to which either the charging provisions of section 5, or the computation provisions of section 8, could apply, and, in my judgment, his claim to have the interest payments deducted in those years inherently involves the unwarranted assumption, that a "loss" on dividend income, is a loss recognised by the statute whereas the only losses known thereto are those contained in paragraph (h) of section 8(1). It also ignores the statutory concept of relating income to sources, and if accepted, would be tantamount to treating the taxpayer as if he himself were the source being taxed, and his shares merely another asset contributing, or capable of contributing to that single source. It also ignores the requirement of paragraph (a) that the capital to which the expenditure relates must be employed in acquiring the income.

There was one other case relied on by the Appellant, and

it .../

It may be appropriate to say a word here about it, since it appears to decide the very point now before me in favour of the taxpayer. That case was Woodroffe v. C.I.R. 10 W.I.R. 48. The headnote for which reads:-

> "The appellant obtained a loan from a bank with which he purchased shares in a company carrying on business in Grenada. For the purpose of ascertaining his chargeable income the appellant claimed a deduction of the interest payable to the bank on the loan. It was contended on the appellant's behalf before the Commissioners that dividends on shares are taxable under s. 5 of the Ordinance, that the loan was used to acquire shares in a company and that these shares would give rise to dividends, that the interest payable on the loan from the bank was therefore interest payable on capital employed in acquiring income and accordingly such interest was allowable under s. 11 (1)(a) of the Ordinance.
>
> For the Comptroller of Inland Revenue it was contended that interest on the loan was not "interest payable on capital employed in acquiring the income", within the meaning of s. 11(1)(a) of the Ordinance, and was not money "wholly and exclusively laid out or expended for the purpose of acquiring the income" under s. 13 of the Ordinance; it was not enough to show that the deduction claimed was made in the course of, or was connected with the acquisition of the income but it had to be shown that it was made in actually producing the income. It was further contended that normally expenditure incurred in the acquisition of a capital asset was not chargeable to revenue in ascertaining profits and would be disallowed for income tax purposes, and accordingly ancilliary expenses, such as interest, which were incurred in a similar connection would likewise ordinarily be disallowed. However, s. 11(1)(a) of the Ordinance allowed deductions to be made in respect of interest payable on money borrowed and used to acquire the assets mentioned therein, viz, "the business, land, building or machinery from the employment or use of which the income arose", but in this case it was submitted that as the interest payable by the appellant was in respect of money used for the purchase of shares in the company, the interest was not allowable as a deduction under this section.
>
> The Commissioners held that "the appellant's claim failed in that s. 11(1)(a) of the Income Tax Ordinance, Cap. 147 (Grenada) appeared to preclude an allowance for interest paid on money borrowed to acquire a capital asset such as shares".
>
> The appellant appealed to the Supreme

Court .../

Court from the decision of the Commissioners, and at the hearing of the appeal the same arguments were adduced by both parties as were urged before the Commissioners.

HELD: (i) Sections 11 and 13 of the Income Tax Ordinance, Cap. 147 (Grenada) are not inconsistent with each other. The interest paid on the loan to acquire the shares must be referable in some way to the production of the appellant's income if it is to be allowed as a deduction under s. 11; on the other hand under s. 13 a deduction will not be allowable if the outgoings or expenses are domestic or private expenses, or are expenses which are not laid out or expended "wholly or exclusively for the purpose of acquiring the income";

(ii) whether or not the shares have produced any income is immaterial provided the interest paid on the loan was payable on capital employed for the production of the income. On the facts the interest was payable on capital employed in acquiring the income and it was therefore allowable as a deduction under s. 11 of the Ordinance.

Appeal allowed.

No cases referred to."

That decision is of course not binding on me, but in any event, it does not appear to have turned on statutory language which is identical to that of the Jamaican Law. Furthermore, the report suggests that the main issue in the case was whether the interest payments there involved were, as a matter of general principle, properly to be regarded as revenue expenditure, under the Grenada Income Tax Ordinance. That is a much broarder point than the one in issue in the instant case, and there is no indication in the report whether the much narrower point now before me, was ever specifically dealt with in the arguments. It is disposed of in a very short passage near the end of the Judgment of Louisy J., in the following terms:-

"It is not clear from the papers before me whether the shares bought have produced any income. However, in my view, whether the shares have produced income or not is immaterial, provided the interest paid was payable on capital employed for the production of income."

That .../

That short reference to the matter, unsupported as it is by reasons, limits any assistance that could otherwise be obtained from the case. There is no indication, for example, whether the taxpayer there had any other income from dividends during the year in question - a fact which would have been quite crucial on the view which I have taken of the Jamaican Law as it applies to the instant case.

In all the circumstances, therefore, since it is not a decision which is binding on me, and since I am quite firm in the view which I have taken of the Jamaican Law as it applies to the instant case, I do not propose to follow or be guided by it.

The other argument relied on by the Appellant, relates to deduction granted by paragraph (e) of section 8(1), i.e., the Capital Allowances provided for in the Second Schedule. It was contended that there was no compelling reason why the allowance under paragraph (a) should be placed on a different footing from that under paragraph (e), where the expenditure was allowable simply on proof that it had been incurred for the purposes of a trade carried on by the taxpayer. There is a short answer to this argument, and it is this. The basis for the deduction under paragraph (e) is to be found, not so much in section 8(1) as in the Second Schedule, which lays down the terms upon which it is granted, and one must therefore look to the schedule to see what that basis is; when this is done, what we find is (taking Paragraph (1) of Part II as an example) that the basis for the allowance is thus expressed:-

> "where ... a trader incurs capital expenditure on the purchase, alteration or improvement of machinery or plant for the purposes of the trade there shall be made to him ... an allowance equal to 20 percentum of such expenditure."

It is patent from this wording that the test to be applied

under .../

under the Second Schedule is fundamentally different from that under paragraph (a). Under the former, all the taxpayer need do to qualify for the allowance, is to prove that the expenditure had been incurred for the purposes of his trade; having done that, it is automatically deemed by paragraph (e) of section 8(1) to have been wholly and exclusively incurred in acquiring the income. Under paragraph (a), however, the burden on the taxpayer is more onerous, he has to prove, in the first place, that the interest was paid on capital employed in acquiring the income; but even where he succeeds in establishing that fact, the deduction will still not be allowable unless he can also show, either that it was paid to someone resident in Jamaica, or, if paid to a non-resident, that tax has been deducted therefrom, or there is someone in Jamaica who can be assessed in respect of the same, or that no tax is payable thereon. These conditions imposed by the proviso to paragraph (a), indicate that the allowance under that paragraph is severely restricted and is always contingent upon the taxpayer establishing, either that the recipient of the interest will be subject to tax thereon, or that the same is, for some sufficient reason not liable to tax in his hands. It is therefore my opinion, and I so hold, that the manner in which the deduction for interest has been so circumscribed by Parliament, is a sufficient and compelling reason for saying that it rests upon a different basis from that under paragraph (e), or for that matter, under any of the other paragraphs of the subsection, since under none of these is there any requirements such as is set out in the proviso to paragraph (a) of the subsection.

For all these reasons, therefore, I have come to the conclusion, and I so hold, that the Appellant has failed to satisfy me that he is entitled to the allowance claimed under

Section .../

Section 8(1)(a) of the Income Tax ~~Law~~ Act 1954, for either of the two years of assessment relevant to this appeal, and I therefore order that the decisions of the Respondent herein, made on the 19th April, 1972, are to be confirmed, and the Appeal dismissed with costs, which I fix at $100.

/s/ D. W. Marsh
(D. W. Marsh)
Puisne Judge - Revenue Court
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