Privy Council Appeal No. 36 *of* 1929.

The Trustees Corporation (India), Limited - - - *Appellants*

v.

The Commissioner of Income Tax, Bombay Presidency - - *Respondent*

FROM

THE HIGH COURT OF JUDICATURE AT BOMBAY.

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 30TH JANUARY, 1930.

Present at the Hearing:

LORD BLANESBURGH.
LORD WARRINGTON OF CLYFFE.
SIR CHARLES SARGANT.

[*Delivered by* LORD BLANESBURGH.]

This is an appeal from a judgment of the High Court of Judicature at Bombay, upon a reference made to that Court by the Commissioners of Income Tax under Section 66 (2) of the Indian Income Tax Act, 1922. The substantial question for decision by the Board is whether the appellants are liable to pay Indian super-tax for the year 1924–1925 on the footing that at the least they made no loss by, so that they are entitled to no credit in respect of, the realisation of a certain block of shares in the Burma Corporation (India), Limited, sold in January, 1924, in the circumstances now to be stated. The High Court have held them to be so liable. Hence this appeal.

The appellants, who will be referred to as the Indian Company, were incorporated under the Indian Companies' Act on the 10th February, 1920; with a nominal capital of seven crores of rupees, divided into 350,000 shares of 200 rupees each. Promoted as a private company by two English companies, the Share Guarantee Trust, Limited, and the Intercontinental Trust (1913), Limited, all the issued shares of the Indian Company, with

the exception of one share taken by each of the two nominee subscribers to its Memorandum of Association, have throughout been held by one or other of the English Companies. Their joint control of the Indian Company has thus been in every respect and at all relevant times complete.

That company was really established that it might acquire from the English Companies, as a single block of 312,817 shares, two separate holdings in the Burma Corporation, Limited, of 134,705 shares belonging to the Share Guarantee Trust, and of 178,112 shares belonging to the Intercontinental Trust. The nominal value of each of these Burma Corporation shares was £1. They were all fully paid, and they stood in the London market at the high price of £14 each.

The terms of their acquisition by the Indian Company were contained in two sets of agreements. To one set, one of the English Companies was party disponing: to the other set, the other. But the agreements of each set were of even date, and their terms were, *mutatis mutandis*, identical. Moreover, since their execution, the respective outstanding interests in the shares of the two disponing Companies have been dealt with as if theirs was the interest of a single person in the entire block. Accuracy, in the circumstances, will accordingly not be seriously endangered, while brevity and convenience of statement will alike be served if their Lordships in what follows proceed, unless otherwise stated, upon the assumption that the entire arrangement was embodied in a series of composite agreements made between the two English Companies on the one side and the Indian Company on the other.

It was by two such agreements executed on the 10th February, 1920—the day of its incorporation—that the Indian Company's interest in the shares originated.

The first of these two agreements resulted in a simple contract for the purchase by the Indian Company of the whole block of the Burma Corporation shares in consideration of the issue of an equal number of shares in the Indian Company credited as fully paid: and, as some form of reconstruction of the Burma Corporation was apparently then in prospect under which each share in the Corporation would in due course be exchanged for 14 shares in Burma Corporation (India), Limited, the agreement contained a provision that if this exchange took place, prior to completion, the sale and purchase should apply to the shares so exchanged. The effect so far was that the Indian Company acquired 312,817 of Burma Corporation shares of £1 each, or their equivalent, in consideration of the issue of 312,817 of its own shares credited as fully paid. And the two separate agreements embodying that result were duly filed.

But the real transaction was contained in the second of the two composite agreements already referred to, the terms of which were not intended to be filed, and were not filed.

By this second agreement, subsequently referred to between the parties and here as the principal agreement, out of the 312,817 shares of the Indian Company representing the then consideration for the Burma shares, one-half—or 156,408 shares—were to or by direction of the respective English Companies to be allotted immediately, while the remaining shares were to be allotted at the rate of one share for each two shares of the Burma Corporation as delivered to the Indian Company. Somewhat inconsistently 25,000 shares in the Burma Corporation were to be delivered to the Indian Company forthwith, while delivery of the "undelivered shares", as prescribed, was to be made on such dates as might be mutually agreed. The whole were, however, to be delivered within three years—that is before the 10th February, 1923. In the meantime possession of the undelivered shares was to be retained by the English Companies, and during the period prior to completion these companies were given power from time to time to deposit and charge the shares for their own liabilities joint or several or for their liabilities jointly with any other parties—up to a limit of two and one-half million pounds sterling. The English Companies were also, by a clause numbered 4, given power with the consent of the Indian Company to sell any of the undelivered shares and either to utilize the proceeds of sale in discharge of such liabilities, in which event—and this, as will later appear, was a significant provision—the purchase consideration was to be "proportionately reduced"—or to remit the proceeds to the Indian Company, in which event "the equivalent purchase consideration for the shares"—another significant provision—was to be duly allotted.

The 156,408 shares of the Indian Company credited as fully paid were duly issued by that Company as provided by the principal agreement. It would not have been easy to harmonize with the other provisions as to allotment the immediate delivery to the Indian Company of the 25,000 Burma Corporation shares. But this difficulty was not allowed to arise for neither these shares nor, indeed, any Burma shares at all were ever delivered to the Indian Company. On the 10th February, 1923, the day of expiration of the period limited for completion, all that had happened was that three years before 156,408 shares of the Indian Company had been issued as fully paid, and, so far, for nothing.

With these circumstances unchanged a further composite agreement was, on the 14th November, 1923, come to by the parties, supplemental to and by way of variation of the original arrangement. By this time the 312,817 shares of the Burma Corporation, Limited, had become 4,379,438 shares of the Burma Corporation (India), Limited, of Rs. 10 each; and by the arrangement as now modified it was provided that these shares need not any of them be delivered before the 10th February, 1926; that the English Companies, with the general or special authority of the

Indian Company might sell any of the shares and should in that event on completion pay to the Indian Company the proceeds of sale, together with all dividends received on the shares and clause 4 of the principal agreement above referred to was modified accordingly. In consideration for this, it was agreed by the English Companies—and this was a modification of the first importance—that the purchase consideration mentioned in the principal agreement should not in any case exceed the 156,408 shares already allotted as above stated.

In a case like the present where the Indian Company was throughout merely another name for the English Companies acting in concert, it would perhaps have been remarkable if these agreements, elastic as are their terms, had not been worked out so as best to meet the convenience of the two English Companies. And so they plainly were. The shares sold remained in the respective names of the two companies, who between them received and retained all the dividends; when the shares were sold they received and retained the entire purchase price: it was only after their sale, actually effected in 1924, that these receipts were even brought into the accounts of the Indian Company; and even this seems to have been little more than a book entry, for, as appears from the evidence of Mr. Sandeman, a director of that Company, no part either of the purchase price or of the dividends had even then been received in India. They remained in England, presumably under the control of the English Companies, and as late as December, 1926, they were, according to his statement, still there.

But this course of dealing, independent as it was of the Indian Company, really involved little more than a generous interpretation in the English Companies' own interests of the actual provisions of the agreements themselves which, properly understood, embodied an arrangement of a most unusual description in no way characteristic of the simple transaction of purchase and sale set forth in the filed agreements.

The agreements left the English Companies with, in effect, the same dominion over the shares as they enjoyed before their so-called sale. With the consent of the Indian Company, which was the merest formality, the English Companies might sell the shares: without even that form of consent, they might pledge them for their own debts or for the debts of themselves or other parties for a sum or sums up to as much as 2½ million pounds. Had the English Companies pledged the shares up to that limit, and had their value fallen below it—and their value did fall far below it by the beginning of 1924, if not before—it would have been open to the English Companies within the terms of their agreements to withdraw the shares from the Indian Company altogether and retain, for nothing, their 156,408 fully paid shares in that Company. Further, if they sold any of the shares, at whatever price, on tendering that price, however small, they were entitled

to one fully paid share of the Indian Company for every 28 rupee shares sold, whatever the discount involved. Finally—and this was the event which happened—on a sale of the shares under the 1923 agreements and on their accounting for the proceeds, the English Companies were entitled to retain the whole of their 156,408 issued shares irrespective of the excess of their par value over the only sum received by the Indian Company in respect of them. As a matter of fact the deficiency below par value on the realisation in 1924 amounted to as much as Rs. 50,04,972, representing a discount of approximately Rs. 32 on each of the 156,408 shares of the Indian Company.

In truth the agreements did not in any real sense enbody a purchase of the Burma Corporation shares by the Indian Company, in consideration of the issue of fully paid shares of that Company. More truly the so-called purchase was an elaborate arrangement under which while, it is true, the Indian Company might in certain events have received delivery of the Burma Corporation shares in specie, it was just as likely that the Indian Company, getting everything to which under the agreements it was entitled would receive a sum of money only, a sum which it was under the arrangement bound to accept in satisfaction whatever its amount might be. And, if their Lordships may here conveniently so far anticipate, the Indian Company has in the events received, and has duly received money only for its shares so issued as fully paid. And not only so, but it has received a sum, less than the nominal value of the shares by the above figure of Rs. 50,04,972, or Rs. 32 each.

In the actual result, therefore, the shares have been issued by the Indian Company at a discount of that amount, and as this is the sum which in this litigation and upon this appeal the appellants, the Indian Company, contend represents the loss sustained by them in respect of this transaction, it is convenient to ask at once whether, even as so far stated by their Lordships, the facts do not furnish an immediate refutation of that contention.

It is, of course, necessarily grounded on the assumption that these issued shares of the Indian Company are in the hands of the English Companies fully paid and free from any liability for calls or otherwise. If the English Companies remain between them liable for the discount which has in fact now materialized then it necessarily follows—for no doubt as to the solvency of either English Company is suggested—that the Indian Company has sustained no loss at all. And upon the facts, as just detailed, that liability is, in their Lordships' judgment, fixed upon the English Companies by the application to this case of the principle enunciated by the Court of Appeal in the case of *Moseley* v. *Koffyfontein Mines, Limited* [1904], 2 Ch. 108, 118, where it was held that if an arrangement for the issue of shares is such that in the course of its due working out there is as much as a possibility

that in the result the shares will have been issued at a discount, then the issue of the shares as fully paid cannot be justified. Here such a discount has in the result actually materialised; its very amount has been ascertained, and their Lordships, applying as they do, the principle just stated, reach the conclusion that the Indian Company's alleged loss has not been proved, and that its present appeal on this simple ground must fail.

But while this view was foreshadowed by the learned Commissioner, neither in the High Court nor in the arguments before the Board was the case dealt with so simply. Their Lordships accordingly will proceed to consider its further aspects.

The English Companies never, it seems, exercised their power of pledging the Burma shares. They retained them all, until in January, 1924, they sold them in England at 8*s*. a share, or Rs. 6 according to the then rate of exchange—making a total consideration of Rs. 2,62,76,628. This is equivalent to a price of £5 12*s*. for each £1 share in the original Burma Corporation. These shares were, as has been stated, worth in British currency £14 each in February, 1920, and there can be no doubt that the English Companies have, by entering into their agreements with the Indian Company, sustained in England a very serious loss which they would have been spared had they in February, 1920, disposed of their Burma shares upon the open market. Nor can their Lordships doubt that this loss has really provoked the complaint made by the Indian Company in this case. But although the English Companies are the Indian Company's only shareholders, the question here is not whether the English Companies have sustained a heavy loss, but whether the Indian Company has sustained any loss at all. And on the assumption which their Lordships now make that the Indian Company's shares must be treated as fully paid that question depends upon the price which on that footing the Indian Company must be taken to have paid for the Burma shares. Did it exceed the sum finally received for them? That is the issue.

Now it is common ground between the parties that the intrinsic value of the Indian Companies' shares on the 10th February, 1920, on the footing that the Company was then entitled to a free Burma Corporation £1 share for each of its 312,817 shares issued or to be issued was, at the then high rate of exchange, Rs. 98 only. How far that value would stand to be reduced if each Burma share instead of being "Good delivery" was one subject to the reservations and so forth of the principal agreement has not been gone into, and it need not for present purposes be here explored. Rs. 98 may without deduction be taken to be the value of each of the 156,408 shares issued in February, 1920, on the footing on which they were then issued. And in the first stages of their present dispute with the Revenue, the Indian Company, through its accountants, was prepared to adopt the then actual value of its shares issued as the criterion

by which should be determined the question whether it had or had not sustained a loss on ultimate realisation. Its claim on this footing, however, was that the release on the 14th November, 1923, of the Indian Company's obligation to issue 312,817 shares or any shares beyond the first issue of 156,408, operated retrospectively to double the value in 1920 of these issued shares, so that each share must be taken to have then represented for the Company an expenditure of Rs. 196. When, however, it was pointed out that while this release of 1923 might enhance the then value of the issued shares in the hands of their holders, it in no way enhanced their value to the Indian Company in 1920, seeing that the shares had then been parted with once and for all, the alternative contention was put forward, on behalf of the Indian Company, and it was the contention placed before the Board, that the value to the Indian Company of its 156,408 shares at the date of issue must be taken to have been their nominal value of Rs. 200 each, no more and no less, on which basis the Indian Company has on realisation sustained, as is admitted, a loss of the above sum of Rs. 50,04,972.

The Indian Company's claim to have this loss allowed as a deduction from its super-tax assessment was in the first instance rejected by the Senior Taxing Officer, not however because the loss had not been sustained, but because, in his view, it was a capital and not a revenue loss.

After a series of appeals, in the course of which the view was taken that in the circumstances no loss of any kind had been sustained, but, on the contrary, a large profit had been made by the Indian Company, the High Court finally, by Order dated the 17th December, 1925, under Section 66 (3) of the Act, directed the Commissioner of Income Tax to make a reference to the High Court of the following question of law arising out of the Indian Company's super-tax assessment for the year 1924 :—

" Whether the Commissioner of Income Tax was not bound in law to take as the price paid for the Burma Corporation shares the nominal value of the shares allotted [by the Indian Company] in payment therefor."

The Commissioner duly made the reference required and, on the matter coming before the High Court for hearing on the 5th October, 1926, that Court made an order purporting to be made in pursuance of Section 66 (4) of the Act directing the Commissioner to deal in particular with a further question, namely, whether the alleged loss was a capital loss, and to find further facts and generally to amend the case. The Commissioner, after a further hearing of the parties, stated an additional case, and submitted to the Court two further questions, namely :—

(A) Whether the alleged loss in question (if any) was a capital loss or revenue loss ; and

(B) Whether the alleged loss in question (if any) can be taken into account in view of the fact that it has

accrued and arisen outside British India in view of the provisions of Sections 4 (1) and (2) of the Income Tax Act, 1922."

Their Lordships propose now to deal only with the original question, although they must refer again to the circumstances in which the other two were stated. With reference to that question, the Commissioner, in his original letter of reference, after stating that each share of the Burma Corporation had been admitted by the Indian Company's accountants to be worth only Rs. 98 on the 10th April, 1920, submitted that the only reasonable inference was that each share of the Indian Company was only worth that amount. This finding was not in question before the Board. In his second letter of reference dealing with the contention which had then been set up that the case of *In re Wragg* [1897], 1 Ch. 796, required the nominal value of the shares issued and that alone to be taken, the Commissioner, after a full review of the agreements which their Lordships have already discussed, stated his conclusion of fact to be that the whole scheme was as a simple purchase and sale of shares, illusory.

The case then again came before the High Court, and on the 5th March, 1928, that Court pronounced the judgment from which the present appeal is brought. Its view, broadly, was that the Court was brought under no compulsion by the decision in *In re Wragg* to take the nominal value of the shares allotted by the Indian Company as necessarily representing the price paid by that Company for the Burma shares. The present case, in the opinion of the learned Chief Justice, was within the exception to that decision stated by A. L. Smith, L.J., in his judgment in *In re Wragg* for that here the parties had themselves in effect—so great was the discrepancy—acknowledged the consideration received to have no relation in point of amount to that nominal value. The real value of each share in the Indian Company as issued could not have exceeded Rs. 98. It might, if other dates were taken, be found to have been even less. It was open to the Court to ascertain the true value. On any computation thereof the case of the Indian Company failed. It had made no loss on realization: on the contrary it had made, expressed in rupees as was right, a large profit—a profit in respect of each of its 156,408 shares worth only Rs. 98 at their date of issue, of as much as Rs. 70.

Now their Lordships are in full agreement that the Indian Company's case failed, as the High Court thought. But if *Wragg's* case has any application to the present, and if it could not otherwise be distinguished, their Lordships would not as at present advised be prepared to follow the High Court in so far as its final order was based upon the distinction there taken. As they understand the observations of Smith, L.J., referred to by the learned Chief Justice, these were confined to a case where upon the face of the agreement for the issue of fully

paid shares it was made apparent that the actual consideration received by the Company was recognised as being definitely less than the paid-up capital issued in respect of it. The observations were not directed to a case like the present where that fact has to be ascertained, if at all, by extrinsic evidence.

But there appears to be a more certain ground upon which *In re Wragg*, if it has any application at all to the present question, may in the view of the Board be distinguished, and that is to be found in the conclusion of the learned Commissioner already stated, that the transaction here regarded as a purchase and sale of shares was illusory altogether. To a case of which so much can be said *In re Wragg* has no application, and that conclusion of the learned Commissioner, as one of fact, was binding upon the High Court as it is also binding upon the Board, supported as it is by ample material, to some of which attention has already been called earlier in this judgment.

Their Lordships, however, do not wish it to be supposed that in their view the decision in *In re Wragg* is in point here at all. Even if, on any application by the Indian Company to make the English Companies liable to contribute in respect of the shares issued to them, these Companies could successfully rely upon *In re Wragg* as a defence, that result in their Lordships' opinion would have no influence upon the fortunes of the appellants' present appeal.

In re Wragg was one of many cases—*In re Almada and Tirito Company* 38 Ch. Div. 415; *Ooregum Gold Mining Company* v. *Roper* [1892] A.C. 125; the *Eddystone Marine Insurance Company* [1893] 3 Ch. 9 are other notable examples—in which the question, always as between a Company or its Liquidator on the one hand and the allottee of the shares issued as fully paid on the other, was whether in his hands the shares were held free from liability for calls or otherwise. There is no such question here. To this litigation, the English Companies, the allottees of the shares, are not parties, nor, in law, are they even privies. The issue is one between the Revenue and the Indian Company only, and the sole question now is what was the real value objectively of the fully paid shares issued to the English Companies by the Indian Company at the date when they were in fact parted with. It is not disputed by the appellants, the Indian Company, that the intrinsic value of these shares, if it had then exceeded their nominal value would have had to be returned as their true value. But their contention is that if, although judged by the same tests, their intrinsic value was then less than their nominal value, that last value, and no less, must be returned as their true value. This, they say, is the result of *In re Wragg*.

Their Lordships have some difficulty in grasping the argument. First of all, it is clear that there are some limitations to be placed upon the influence of *In re Wragg*. If, for example, the shares here had been issued to an individual who died on the next

day, it could hardly even have been contended that by reason of *In re Wragg* his estate would be charged with death duties in respect of any other than the real value of the shares whether that value was above or below their nominal value. Again, if immediately after the issue of the shares here the Company, upon proper resolutions passed, had presented a petition for the reduction of its capital on the ground that except to the extent of Rs. 98 per share its issued capital of 156,408 fully paid was unrepresented by available assets, can it be supposed that *In re Wragg* would, of itself, have been any obstacle to an order confirming the reduction being made? Why then should that decision stand in the way of the real value of the shares being now in like manner ascertained? Their Lordships can only suppose the answer to be that the view is subconsciously assumed that a company by the issue of a share credited with a definite sum as paid thereon, becomes in some sense a debtor to its shareholder in respect of that full amount. But of course that is not so. A company is in no sense debtor to capital. *Lee* v. *Neuchatel Asphalte Company* 41 Ch. Div. 1; *Verner* v. *General Trust* [1894] 2 Ch. 239. The amount credited upon a share may, as between one shareholder and another, while the company is a going concern, determine the proportion of profits receivable by him as dividend, and, in a winding-up, his proportion of surplus assets. But it has no influence to extend or increase the aggregate amount available for division in due course of administration amongst the whole body of shareholders; nor does it make the company a debtor for any sum at all.

In their Lordships' judgment accordingly the decision in *In re Wragg* ought to have no influence upon the question now raised, so that, however its claim be regarded, this appeal of the Indian Company fails.

Before parting with the case their Lordships think it right to allude again to the presentation to the High Court of the two additional questions to which they have already made reference, but which it is unnecessary for them further to consider. In the present case the only result of the presentation of these two questions was that a final decision of the case, on the first and only essential question, was delayed for nearly a year and a-half and much additional expense was incurred. Their Lordships are fully alive to the circumstances in which the High Court was constrained to direct that these further questions should be referred to it for consideration, and the result in the present case of the order then made merely serves to confirm the view of the Board that the High Court will, in future cases, be well advised to require, before they seek to entertain any question under Section 66 of the Indian Income Tax Act, that the preliminary requirements of the Section are strictly complied with.

The stringency of these requirements is clearly deliberate.

It is the intention of the enactment that the High Court is not to be flooded with such applications. The object is salutary and in their Lordships' judgment the High Court will be well advised, before they entertain any question under the section, always to see that the preliminary statutory conditions have been fully observed.

Upon the whole case, for the reasons they have given, their Lordships will humbly advise His Majesty that this appeal be dismissed with costs.

In the Privy Council.

THE TRUSTEES CORPORATION (INDIA), LIMITED

v.

THE COMMISSIONER OF INCOME TAX, BOMBAY PRESIDENCY.

DELIVERED BY LORD BLANESBURGH.

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