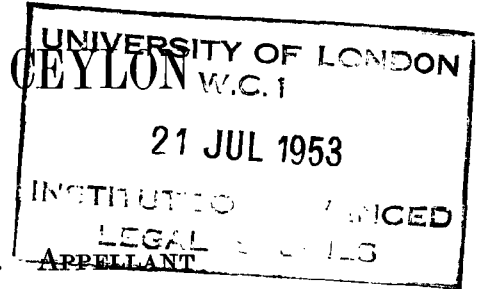


In the Privy Council.

No. 23 of 1951.

ON APPEAL
FROM THE SUPREME COURT OF CEYLON



BETWEEN
THE ATTORNEY GENERAL OF CEYLON APPELLANT
AND
CHARLES WILLIAM MACKIE (Junior) and JAMES
CRAIB MACKIE the Executors of the Will of
CHARLES WILLIAM MACKIE, deceased RESPONDENTS.

CASE FOR THE APPELLANT

1.—This Appeal relates to the value for assessment to estate duty to be placed upon the 5,000 Management Shares of C. W. Mackie & Company, Limited (hereinafter called "the Company") which formed part of the Ceylon Estate of the late Charles William Mackie (hereinafter called "the Deceased") who died on the 7th September, 1940. A Judgment of the District Court of Colombo (affirming the official valuations) fixed the value at Rs. 250 per share but on appeal the Supreme Court of Ceylon by decree dated the 6th September, 1940, granted relief on the footing that the shares should be valued at Rs. 40.6188 per share. From that decree this appeal is
10 brought.

2.—The Respondents (hereinafter referred to as "the Executors") are the Executors of the Will of the Deceased. They are the sons of the Deceased and directors of the Company.

3.—The relevant Ceylon statute at the death of the Deceased was the Estate Duty Ordinance of 1938. Section 3 of that Ordinance provided for the payment of Estate Duty upon the value of the Ceylon Estate of every person dying on or after the 1st April, 1937, and by Section 20 of the Ordinance (so far as relevant to this case) it was provided that the value of any property should be estimated to be the price which, in the opinion of an
20 assessor, such property would fetch if sold in the open market at the time of the death of the deceased, and no reductions should be made in the estimate

on account of the estimate being made on the assumption that the whole property is to be placed on the market at one and the same time, with a proviso that where it is proved to the satisfaction of an assessor that the value of the property has been depreciated by reason of the death of the deceased the assessor in fixing the price should take such depreciation into account.

4.—Sections 34 to 43 of the Ordinance provide for appeals from assessments, including appeals on the ground of value. Notice of his objection is to be served by an appellant in the first instance on the Commissioner of Estate Duty who is to notify the appellant whether he has determined to maintain the assessment in whole or in part. Upon receiving the notification the appellant may proceed with his appeal by filing a petition of appeal in the appropriate District Court and serving a copy on the Attorney General, when the appeal is to be treated as an action between the appellant as Plaintiff and the Crown as Defendant. Section 40 provides that the decree in any such action shall specify the amount (if any) which the appellant is liable to pay as Estate Duty and Section 43 provides for appeals by a like procedure to the Supreme Court from decisions of a District Court. 10

5.—The Deceased was of Scottish birth. He went out to Ceylon in the year 1908, and in or shortly after that year started there a business of buying and selling rubber. In the year 1922 the business was transferred to the Company which was incorporated for that purpose. He remained in Ceylon managing the business of the Company (of which he was Governing Director) until the year 1930 when he returned to Scotland, living in Aberdeen until his death. 20

After his return to Scotland the trading policy established by him continued in force but the actual day to day management devolved upon the other directors who at the death of the Deceased were the Executors and the Witness A. E. Williams (see the evidence of A. E. Williams at pp. 58, 60 and 62 of the Record). 30

6.—The business of the Company was on a large scale, covering roughly between 25 and 30 per cent. of the whole of the rubber export from Ceylon.

7.—The capital of the Company was Rs. 1,000,000, divided into 19,800 8 per cent. Cumulative Preference Shares each of Rs. 50 and 5,000 Management Shares each of Rs. 2, but all carrying equal voting rights. Of these shares, the Deceased held at his death 9,201 Preference Shares and the whole of the Management Shares.

8.—Under the Articles of Association of the Company the Deceased enjoyed special privileges and exemptions as Governing Director but subject thereto the Articles of Association contained provisions to the following effect :— 40

- 10
- (a) that no member could transfer any shares without first giving the other members an option to purchase the shares at a fair value fixed by the auditors ;
 - (b) that the holder of not less than 9/10ths of the share capital could call for a transfer of any other shares on the same terms ;
 - (c) that on the death of a Director the surviving Directors might call for a transfer to them of his shares on like terms ;
 - (d) that no member could be interested in any way in any business which the Company was authorised to carry on or within five years after ceasing to be a member be interested in any business of a Merchant or Produce Broker or Commission Agent in the Island of Ceylon.

The estate of the Deceased included a sufficient number of Preference Shares to protect a purchaser of the Management Shares against the operation of the restriction (b).

9.—By an additional notice of assessment dated the 21st April, 1944, the assessor valued the 9,201 Preference Shares at Rs. 90 per share (amounting to Rs. 828,090 in all) and the Management Shares at Rs. 300 per share (amounting to Rs. 1,500,000 in all).

- 20 10.—The Executors served on the Commissioner of Estate Duty a notice of objection to the assessor's valuation, claiming that the Preference Shares should be valued at Rs. 87.601 per share (amounting to Rs. 806,107 in all) and the Management Shares at Rs. 40.6188 per share less Rs. 10.6188 per share for depreciation owing to the death of the Deceased.

11.—The Commissioner notified the Executors his determination to maintain the said assessments subject to reduction of the valuation of the Management Shares to Rs. 250 per share, and thereupon the Executors filed their petition of appeal and served a copy thereof on the Attorney General.

- 30 12.—The resulting action came on for hearing before the District Judge on the 19th October, 1948, when the following issues were framed :—

- 40
- (1) Is the market value of the Preference and Management Shares in the assessment excessive ?
 - (2) Should the Preference Shares be valued at Rs. 87.601 per share as stated in the petition or at what sum ?
 - (3) Should the Management Shares be valued at Rs. 40.6188 without taking into account any depreciation due to the death of the Deceased ?
 - (4) Did any goodwill attach to the Management Shares at the date of the death of the Deceased and if so at what figure ?

- (5) Was the value of the Management Shares as computed in terms of Section 20 (1) of the Estate Duty Ordinance Rs. 1,250,000 and, if not, what sum ?

13.—At an early stage of the hearing the Attorney General agreed to accept the Executors' valuation of the Preference Shares at Rs. 87,601 per share and the action thereafter related only to the value of the Management Shares. In the course of the proceedings the Executors withdrew their claim to deduct any sum for depreciation from their valuation at Rs. 40,6188 per share for those shares.

14.—The first witness called for the Executors was Mr. F. B. Lander, 10 a member of the firm of Ford, Rhodes, Thornton & Co., Chartered Accountants, who had valued the shares on behalf of the Executors and explained his valuation. The figure was obtained from the Balance Sheet of the business for the 30th June, 1940, adjusted by bringing in the profit earned between that date and the death and it was arrived at by deducting the liabilities and accrued preferential dividend from the total assets so shown.

15.—It is submitted that this method of valuation is not appropriate to the case of shares in a going business. It is not the method by which the market is influenced and it disregards the element of goodwill (or the reverse) 20 which must be present in almost every case.

16.—This witness laid great stress on what he described as the "speculative" nature of the business yielding both high profits and large losses and showing no indication of a steady earning power, and he inferred that no one would have risked any considerable capital in such a speculative adventure at the most critical stage in the war. He admitted that the Company had a reputation for good trading and a good name.

17.—The same witness produced a statement printed at pp. 366/7 of the Record showing the profit or loss made by the Company in each of the years from 1922 to 1939 and in the period from 1st January to the 30 6th September, 1940. (The profit for the whole of the year 1940 is shown by the Balance Sheet at p. 357 of the Record to have been Rs. 636,043.) These figures show that the results of the Company's trading fluctuated very widely but that in the long run very substantial profits were made, and they also show that very large profits were being made at the date of the death of the Deceased. The statement referred to also shows that in the five good years from 1922 to 1926 the Management Shares carried dividends amounting in all to Rs. 1,950,000. The statement shows heavy losses in the five following years (which included the world depression) with a return to a profit making basis in the year 1933, and it is submitted that on the whole 40 the statement discloses an element of stability in the Company's business that should exempt it from classification as "a gamble." Averaged over the

life of the Company it shows an annual profit of Rs. 100,000 per annum over and above the sum required for the Preference Share dividend, and over the period from 1933 to 1940 (i.e. since the return to a profit making basis) an average annual excess profit of Rs. 159,681.

18.—The Witness A. E. Williams (who was at first an assistant in the Company's business and afterwards a director) gave evidence as to the character of the Company's business. The Company's rubber was well known in the London and New York markets ; sufficiently so to establish a " Mackie Standard " of quality known in every market in the world.
 10 The Company bought rubber direct from the estates. The estates sent down " No. 1 rubber " which the Company regraded in its Stores, for its own good name. The Company had dealer agents as well as broker agents in London and other places. It carried very large stocks (p. 57).

19.—The Witness spoke of the state of the rubber market in Ceylon at the date of the death of the Deceased. He considered that as the war was on the price of rubber would be high. After suggesting at first that lack of shipping would hold up the trade in answer to a question from the Court he expressed the view that one or other of the belligerents could have found freight (p. 62).

20 20.—A third Witness called for the Executors, Leslie Percival Hayward, was Managing Director at Colombo of The Rubber & Produce Traders, Limited. This witness expressed opinions on various matters and especially as to the possible but highly hypothetical effect of the manufacture of synthetic rubber upon the market for plantation rubber " if the cost of production of plantation rubber goes up very high." He expressed a view that there is " no goodwill in a rubber business," but it is submitted that a business, the name of which is associated throughout the world with a highly reputed standard of quality and works through agents in important trade centres must in the nature of things be capable of possessing a valuable
 30 goodwill.

21.—The last Witness called for the Executors was Mr. Thomas Cuming, a Produce Broker. He appears to have had no qualification for valuing shares not quoted on the Stock Exchange. He said in answer to questions " I am not an accountant. I have been supervising the selling of rubber. I have had experience of valuing shares in companies for probate. From the Share List we give a valuation of the shares. We look at the Share List. It is not easy if the shares have not been valued for years. It is very difficult " in the case of a private firm like Mackies."

22.—In the circumstances it is submitted that his expression of opinion
 40 that the Management Shares could not have been sold for more than their nominal value should not carry weight.

23.—The principal Witness for the Attorney-General was L. G. Gunasekera, Assistant Commissioner of Income Tax and Estate Duty, who had acted for 11 years as assessor on the estate duty side of the Ceylon Income Tax Department and in that capacity had experience of valuing shares in companies for death duties and *ad valorem* stamp duties.

24.—He based his valuation on the 4-2/3 years ending with the death of the Deceased beginning with the year 1936. In this period the profits were :—

1936...	...	...	...	Rs. 97,391	
1938...	...	...	...	149,485	10
1939...	...	...	...	787,640	
1940 (8 months)	...	...	...	454,532	

Against these profits a loss of Rs. 42,003 in the year 1937 has to be deducted, leaving a net profit of Rs. 1,447,045 for the period equal to a yearly average of Rs. 310,080. After deduction from this of the amount of the preferential dividend of Rs. 79,200 there remains the annual sum of Rs. 230,990 for the benefit of the holder of the Management Shares. On the footing that on an investment in Management shares a return of 15 per cent. per annum would be expected, the Witness arrived at a capital value of Rs. 1,539,200 for the 5,000 shares which he “rounded off” at Rs. 1,500,000 or Rs. 300 per share. 20
The Commissioner’s reduced valuation of Rs. 250 per share would correspond with a rate of between 16 and 17 per cent. as the expected return from the investment.

25.—He supported this valuation by the consideration that the profits at the date of the death of the Deceased had been showing a sharp upward trend and that if this had been maintained for two more years at the level of the two previous years they would bring in the whole amount of the purchase price and if for three years a handsome profit in addition.

26.—He admitted in cross-examination that he had not considered the special conditions governing transfers of shares in the Company’s Articles 30 of Association or allowed for possible increases of taxation and that his valuation depended upon the high level of profits being maintained for several years after the death of the Deceased. It is submitted that in the circumstances of this case these considerations can be set off against the Commissioner’s reduction of the assessment from Rs. 300 per share to Rs. 250.

27.—The other Witness for the Attorney-General was Mr. K. Satchithananda, a Chartered Accountant. He supported a valuation of Rs. 270 per share by reference to a system known as the “weighted” method, estimating the future profits by the “weighted average” of the previous 40 five years’ profits. In applying this method on the basis of a five-years’ term the total is ascertained of the profits of the first year of the series twice the profits of the second year three times the profit of the third year, and

so on, and the total so obtained is divided by 15. His valuation on this basis is set out at p. 369 of the Record but it was admitted in his cross-examination that he had made errors of calculation in applying the method and that a correction of the errors would increase the valuation to Rs. 334 per share. The Attorney-General does not in this appeal contend that the "weighted" method is appropriate to the circumstances of the present case.

28.—Much stress was laid by the Executors' Witnesses on the "speculative" character of the business and it was described as "a gamble." 10 The only justification for this view of the business was the fact that it carried large stocks, which would rise or fall in value with the prices prevailing on the rubber market, where prices sometimes fluctuated considerably. It is submitted that these terms are not fairly applied to a straightforward business of buying, grading and selling goods merely because the business necessarily carries large stocks liable to fluctuate in value.

29.—The Judgment of the District Court (S.S.J. Goonesekere, Additional District Judge) was delivered on the 31st August, 1949. The Judge accepted in substance the method of valuation adopted and reasons adduced by the Attorney-General's first witness leading to a valuation of Rs. 300 per 20 share but insomuch as the expected return of 15 per cent. on the price as assessed by the witness was slightly on the low side he formed the opinion that Rs. 250 per Management Share was very fair. In arriving at this conclusion the learned Judge relied (*inter alia*) upon the general character and reputation of the business, and upon the high price of rubber at the date of the death of the Deceased and the probability of its maintenance during the continuance of the war. He did not accept the view that at that date the state of the war would have deterred purchasers from buying the shares or that there were then no purchasers for shares in rubber companies. A comparison of the Exhibits R.12 and R.13 showed that the market for 30 rubber shares had improved between the 30th August, 1939, and the death of the deceased. He did not accept the view that the death of the Deceased after ten years' absence from Ceylon had affected to any appreciable extent the market value of the Company's shares.

30.—The Judgment of the Supreme Court (Jayetilleke, C.J., and Gratiaen, J.) was delivered on the 22nd May, 1950.

31.—The Chief Justice laid great stress upon the speculative character of dealings in rubber, the difficulty of foreseeing the course of the rubber market, the history of the Company showing great differences in result of successive periods of five years trading and regarded all these considerations 40 as leading to a valuation on the basis of tangible assets and he considered that in valuing on that basis no value could be placed upon goodwill in the case of dealings so speculative as those in rubber. He also criticised the valuation of Mr. Gunasekera on various grounds :—

- (i) that the proper risk rate to assume would be 20 per cent. instead of 15 per cent. and would reduce his valuation to Rs. 190 per share ;
- (ii) that his valuation made no allowance for reserves and that an annual reserve of Rs. 150,000 would reduce the valuation to about Rs. 80 per share ;
- (iii) an allowance of 15 per cent. for tax would bring it down to Rs. 30 per share ; and
- (iv) that the existence of the restrictions on transfer would still further depress the value. 10

In the result his opinion was that the valuation of Rs. 40 per share was a fair one.

32.—Mr. Justice Gratiaen approached the valuation by way of a quotation from the Judgment of Lord Fleming on the case of *Salveson's Trustees v. C.I.R.* 1930 *S.J.T.* 387 (and 9 *Annotated Tax Cases* 43).

“ The problem can only be dealt with by considering all the relevant factors as known at the date of the Deceased's death, in order to determine what a prudent investor, who knew those facts, might be expected to be willing to pay for the shares.” “ I propose ” (said Gratiaen, J.) “ to adopt this method of approach in the present case. Having first discussed what appear to me to be the factors for consideration by a prudent purchaser invited to make an offer for the shares, I shall then proceed to apply the method of valuation which seems most appropriate to the case.” These factors he stated thus :— 20

- “ (1) the nature of the business of the Company ;
- “ (2) the history of the Company from its inception up to “ 6th September, 1940 ;
- “ (3) the future prospects of the business generally, and of the “ Company in particular ;
- “ (4) the state of the investment market at the relevant date ; and 30
- “ (5) the extent, if any, to which the restrictions contained in the “ Articles of Association might be expected to depreciate the “ value of the shares.”

33.— He then proceeded to deal with each of these factors. He stressed the speculative character of a business carrying large stocks of a commodity of fluctuating value and referred to the record of the Company for confirmation.

34.—It is submitted that the record shows that :

- (1) the speculative character of the Company's business has been overrated ; and 40

- (2) the business was capable of returning very handsome profits and that at the relevant date a period of prosperity appeared to be in progress.
- (3) that the business has been established only with the aid of its large body of preference capital, the need for which is an important protection against competition.

This criticism applies to the learned Judge's comments on the first three factors. As to the market conditions the Exhibits R.12 and 13 show that the market actually improved between the years 1939-1940. It is
 10 submitted that the restrictions on transfer and other provisions of the Articles of Association would cause little apprehension to a purchaser holding a majority of the voting powers in the Company and relying upon a few prosperous years to repay his capital with interest.

35.—Reducing the valuation of the shares by reference to the five factors the learned Judge came to the conclusion that the figure of Rs. 40.6188 per share was a fair one and that the business comprised no goodwill capable of valuation.

36.—The Appellant humbly submits that the Order of the Supreme Court of Ceylon was erroneous and that the Order of the District Court of
 20 Colombo should be restored for the following among other

REASONS

- (1) BECAUSE the method of valuation applied by the Executor's Witnesses is not appropriate to a case of a continuing business in which large profits are being earned or in prospect.
- (2) BECAUSE an assets valuation of the shares of a company which is earning large profits is incomplete unless goodwill is taken into account.
- (3) BECAUSE the reputation, established connections and organisation of the Company's business were necessarily of value to a purchaser of the Company's shares and alone imply a goodwill for which some payment would naturally be made and the Order appealed from allows none.
 30
- (4) BECAUSE at the death of the Deceased the Company was on a wave of prosperity the benefit of which a purchaser of the shareholding of the Deceased would have been in a position to appropriate without being hampered by the restrictions on transfer contained in the Company's Articles of Association and without the necessity of leaving reserves in the Company.

- (5) BECAUSE the Supreme Court overrated the adverse effect of the speculative character of the rubber trade on the value of the Company's shares, this character being capable of producing very large profits as well as losses and at the critical time profits were prevailing.
- (6) BECAUSE the Supreme Court underrated the value and importance of the Company's large volume of preference capital.
- (7) BECAUSE the existence of the war was a factor tending to prosperity in the rubber trade by which a purchaser of the Company's Management Shares would expect to profit. 10
- (8) BECAUSE the evidence of the Executor's Witnesses does not establish any value that can properly be substituted for the value adopted by the Commissioner.
- (9) BECAUSE the Order of the District Court of Colombo is correct and ought to be restored.

F. SOSKICE.
J. H. STAMP.

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CASE FOR THE APPELLANT

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