

11, 1957

No. 16 of 1956.

# In the Privy Council.

## ON APPEAL FROM THE SUPREME COURT OF CEYLON.

UNIVERSITY OF LONDON

25 FEB 1958

INSTITUTE OF ADVANCED  
LEGAL STUDIES

49849

BETWEEN

CECIL ALEXANDER SPELDEWINDE, Com-  
missioner of Income Tax, Colombo . . . . . Appellant

AND

EMIL SAVUNDRANAYAGAM . . . . . Respondent.

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## Case for the Respondent.

RECORD.

1. This is an Appeal from a Decree of the Supreme Court of the Island of Ceylon (Gratiaen and Sansoni, JJ.) dated the 18th March, 1955, allowing an appeal by the Respondent by way of Case Stated from a decision of the Income Tax Board of Review dated the 6th May, 1953, whereby an appeal by the Respondent from the determination of the Appellant dated the 20th November, 1952, was dismissed and an additional assessment of Income Tax made on the Respondent for the year of assessment 1950/51 was varied from Rs. 1,621,343 to Rs. 1,323,888. p. 241. p. 210.

20 2. The question which arises on this appeal is whether three sums of Rs. 1,110,264, Rs. 180,000 and Rs. 5,000 respectively should be included in the assessable income of the Respondent for the year of assessment 1950/51.

3. The facts of the case appear from the Case Stated by the Board of Review under Section 74 of the Income Tax Ordinance for the opinion of the Supreme Court and the documents annexed thereto, and are summarised below. p. 1.

30 The Respondent was concerned in the formation and was a director of two private companies called respectively Transworld Enterprises, Limited and Eastern Traders, Limited. In October, 1950, following negotiations with a representative of a Chinese company, the Hwa Shih Company, the Respondent on behalf of Transworld Enterprises, Limited, accepted an order to supply 45,000 drums of lubricants of various specifications to be shipped direct to Tsingtao, China, at a c.i.f. price of 1,230,000 dollars, it being a term of the contract that the buyer would

open a letter of credit with a Bank to be nominated in Ceylon, India or Switzerland in favour of a firm called the Eastern Enterprises Company. This firm was a partnership consisting of the two companies referred to above.

p. 50.

In November, 1950, the Chinese company made arrangements to open a letter of credit in favour of the Eastern Enterprises Company with the Union Bank of Switzerland at Zurich for the sum of 1,230,000 dollars whereby the Bank undertook to pay this sum against bills drawn by the Eastern Enterprises Company accompanied by certain specified documents which would provide evidence of the shipment of the cargo of lubricants. 10

At or about the same time the Respondent, acting on behalf of the Eastern Enterprises Company under a comprehensive power of attorney, entered into negotiations with one Pierre Duval whom the Respondent understood to be a director of the Societe Mediterrannienne de Produits Petroliers, one of the companies which the representative of the Chinese company had suggested should be approached with a view to obtaining the required lubricants. It was agreed between the Respondent and Duval that the latter's company should provide and ship the required lubricants from Marseilles to Tsingtao for 825,552.50 dollars. It was arranged that following the shipment of the oil the necessary documents should be sent 20 to the Respondent who would in turn present them to the Swiss Bank together with a bill of exchange drawn on the Chinese company.

Early in January, 1951, Duval represented to the Respondent that the lubricants had been shipped on a Swedish ship named the "Saja" and forwarded what purported to be the required documents in proof of shipment. These the Respondent presented to the Swiss Bank together with the appropriate bill of exchange and after considering the documents for four days the Swiss Bank made the full payment of 1,230,000 dollars to the Respondent as attorney of the Eastern Enterprises Company.

At the time when the documents were presented and the payment 30 of 1,230,000 dollars was made by the Swiss Bank, both the Respondent and the Bank believed that the "Saja" had sailed, that the cargo of lubricants had been shipped and was on its way to China, and that the documents forwarded by Duval were genuine documents. In fact, as was subsequently discovered, there was no ship and no cargo of lubricants, and the documents were forgeries.

Out of the sum of 1,230,000 dollars received from the Swiss Bank the Respondent as attorney of the Eastern Enterprises Company paid 825,552.50 dollars to Duval on behalf of his Company, as the agreed price of the goods supposed to have been supplied and shipped. The Respondent next transferred a sum of 169,447.50 dollars by telegraphic 40 transfer to the credit of Transworld Enterprises, Limited, at the Bank of Ceylon, Colombo. In addition, the Respondent, as attorney of the Eastern Enterprises Company, drew the sum of 235,000 dollars in cash. These three items, the 825,552.50, the 169,447.50 and the 235,000 dollars account for the whole of the 1,230,000 dollars received from the Swiss Bank.

Out of the sum of 169,447.50 dollars (equivalent to Rs. 804,875) transferred to Transworld Enterprises, Limited, the Respondent and his wife received Rs. 180,000 described as a dividend, paid on the shares in the Company held by them, and a further Rs. 5,000 described as director's fees. The sum of 235,000 dollars received by the Respondent from the Swiss Bank is equivalent to Rs. 1,110,264 and it is these three items, the Rs. 1,110,264, the Rs. 180,000 and the Rs. 5,000 which are the subject-matter of this appeal.

4. An assessment was made upon the Respondent for the year  
10 1950-51 in the sum of Rs. 1,870,000. The Respondent appealed against  
this assessment to the Appellant under Section 69 of the Income Tax p. 150.  
Ordinance.

This appeal was heard in October and November, 1952. The Assessor p. 210.  
contended that the setting up of the two companies, Transworld  
Enterprises, Limited, and Eastern Traders, Limited, was artificial and  
could be disregarded under Section 52 (2) of the Income Tax Ordinance  
and that the taxable profit of the Respondent derived from the transaction p. 223.  
amounted to Rs. 1,592,719. The Respondent admittedly had other  
income amounting to Rs. 28,624 so that the total assessment for which  
20 the Assessor contended was Rs. 1,621,343. The Appellant dismissed the  
Respondent's appeal and fixed the assessment at the sum computed by  
the Assessor. p. 224.

The Appellant—the Commissioner of Income Tax—accepted the  
contention of the Assessor that the formation of the partnership between  
the two companies was artificial and should be disregarded under  
Section 52 (2) of the Income Tax Ordinance. He regarded it as clear that  
the Respondent had received both the sum transferred by telegraphic  
transfer to the credit of Transworld Enterprises, Limited, and the sum  
drawn in cash from the Swiss Bank. He expressed the view that both  
30 sums were received by the Respondent as his profits. He rejected the  
argument advanced on the Respondent's behalf that any sums received  
by the Respondent were received under a contract for which the con-  
sideration had wholly failed and that the Chinese company could recover  
these sums from the Respondent, the ground of his rejection of the  
argument being that no contract had been proved. Accordingly the p. 226.  
Appellant held that the legal title to the money in question was in the  
Respondent. p. 227.

5. The Respondent appealed to the Board of Review under Section 71 p. 5.  
of the Income Tax Ordinance. This appeal was heard in January, March p. 241.  
40 and April, 1953.

The Board found, *inter alia*, that there was a contract in the terms  
set out in the letter of credit, that as a result of the forged documents p. 50.  
tendered by Duval which the Respondent accepted at the time as being  
genuine and presented bona fide to the Bank, the Bank made the payment  
of 1,230,000 dollars, and that it was not until later that Duval's fraud  
was discovered. The Board, however, took the view that the Eastern  
Enterprises Company had done all that they were required to do. p. 246.

As to the three specific items mentioned in paragraph 2 above the Board held that a sum of Rs. 300,000, part of the sum transferred to Transworld Enterprises, Limited, by the Respondent, was treated by that company as a profit out of which a dividend was declared and that the sum of Rs. 180,000 was received by the Respondent and his wife as their share of the dividend so declared; the Board held that in addition a further sum of Rs. 5,000 was paid to the Respondent as director's fees. The Board also held that the sum of Rs. 1,110,264, representing the 235,000 dollars received by the Respondent from the Swiss Bank in cash was a sum paid by the Respondent as attorney of the Eastern Enterprises 10 Company to himself in his personal capacity as commission earned by him for his part in the transaction.

p. 249.

The contention was advanced on behalf of the Respondent that the money received by the Respondent was not the Respondent's money because, in the events which had happened, it was money had and received on behalf of the Swiss Bank or the Chinese company. This contention was rejected by the Board on the grounds, shortly put, (i) that the Eastern Enterprises Company had performed all that they were required to do to effectuate the shipment of the lubricants and so earn their profit on the transaction, (ii) that the money received by the Respondent was received 20 bona fide and for consideration since the Respondent had no notice of any defect in title when he received the money and the money was therefore his money when he received it, and (iii) that even if the Swiss Bank or the Chinese company had a claim to recover all or any part of the money received by the Respondent that claim was only a contingent claim and did not affect the Respondent's liability to tax in respect of the money actually received.

p. 251.

p. 259.

The Board further justified the finding that the sum of Rs. 180,000 and the sum of Rs. 5,000 were taxable by express reference to Section 52 (2) of the Income Tax Ordinance which provides that in certain circumstances 30 an artificial or fictitious transaction or a disposition which is not in fact given effect to may be disregarded. On this footing the Board considered that the payment of the dividend and of director's fees could be disregarded as being artificial and the two sums of Rs. 180,000 and Rs. 5,000 could for tax purposes be treated as profits from a trade.

pp. 247 and 259.

The Board accordingly held that the Respondent was accountable for the year 1950/51 as follows :—

	Rs.	
(1) The equivalent of the 235,000 dollars received by the Respondent from the Swiss Bank .. ..	1,110,264	40
(2) The sum paid to the Respondent and his wife as dividend .. ..	180,000	
(3) Director's fees .. ..	5,000	
(4) Other income of the Respondent .. ..	28,624	
Total .. ..	<u>Rs. 1,323,888</u>	

6. In accordance with the provisions of Section 74 of the Income Tax Ordinance the Respondent made an application requiring the Board of Review to state a Case for the opinion of the Supreme Court. The Board duly stated a Case on the 28th August, 1953. p. 259.  
p. 1.

The questions of law arising in the appeal as stated by the Board raised, *inter alia*, these issues :—

(1) whether the sums received by the Respondent were received by him as his own property or income or as the property or income of the Eastern Enterprises Company, or whether those sums by reason of a mistake of fact at all times remained the property of the Swiss Bank or of the Chinese company ;

(2) whether by reason of a total failure of consideration the Respondent or the Eastern Enterprises Company at all times remained accountable to the Swiss Bank or the Chinese company for all sums received by the Respondent from the Swiss Bank ; and

(3) whether any money received by the Respondent or the Eastern Enterprises Company was a profit of a casual and non-recurring nature and as such not “ profits ” or “ income ” within the meaning of Section 6 of the Income Tax Ordinance.

7. The Respondent's appeal by way of a Case Stated was argued before Gratiaen and Sansoni, JJ., on the 24th, 25th and 28th February, 1955, and judgment was delivered on the 4th March, 1955. The appeal was allowed with costs and the Supreme Court directed that the assessment on the Respondent be reduced by deleting the sums of Rs. 1,110,264, Rs. 180,000 and Rs. 5,000. p. 10.  
p. 16.

Before the Supreme Court it was contended on behalf of the Appellant that the conclusions reached by the Board of Review were correct, that the partnership, the Eastern Enterprises Company, had earned its profit from the transaction and that the Respondent had earned his commission and had a good title to the dividends and director's fees received by him. It was argued in the alternative that, even if money had become liable to be refunded by the partnership when the mistake became known, the money received by the Respondent and his wife could not be followed in their hands.

For the Respondent it was contended that the payment of the money was void *ab initio* and that no property in the sums received ever passed to the partnership or thereafter from the partnership, or the corporate partners to the Respondent or his wife.

In his judgment, Gratiaen, J., with whom Sansoni, J., agreed, rejected, correctly as it is submitted, the legal inferences drawn by the Board from the facts and in particular the theory advanced by the Board of Review that the Eastern Enterprises Company had done all that it was required to do in order to earn the purchase price. The learned Judge held that the money was paid by the Swiss Bank and received by the Respondent on behalf of the partnership under a mistake of fact or misapprehension as to the substance of the consideration going as it were to the root of

p. 14.

the matter and that the mistake or misapprehension was so fundamental as to render the transaction and the payment void *ab initio*. In the circumstances, the money received from the Swiss Bank never passed into the ownership of the partnership or of the Respondent. Notwithstanding that the Respondent may have acted bona fide in paying himself the sum of Rs. 1,110,264 as commission or in receiving the sum of Rs. 180,000 by way of dividend or the sum of Rs. 5,000 by way of director's fees, the ownership in those sums never passed to the Respondent by reason of the fundamental mistake upon which the payment of the sums was based.

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8. The Respondent humbly submits that the decision of the Supreme Court of Ceylon is right, and should be affirmed, and that this appeal should be dismissed with costs for the following amongst other

### REASONS.

- (1) BECAUSE the three sums of Rs. 1,110,264, Rs. 180,000 and Rs. 5,000 were part of the amount of 1,230,000 dollars paid by the Union Bank of Switzerland, Zurich, on behalf of the Hwa Shih Company under a mistake of fact so fundamental as to prevent any part of the sum paid becoming the property of the recipient or any person claiming through the recipient. 20
- (2) BECAUSE the said amount of 1,230,000 dollars of which the said three sums formed part was money had and received by the Respondent for the use of the Union Bank of Switzerland or the Hwa Shih Company and was therefore not the income and formed no part of the profits of the Respondent or of the partnership known as the Eastern Enterprises Company or of the individual corporate partners within the meaning of Section 6 of the Income Tax Ordinance or at all. 30
- (3) BECAUSE the Respondent and the said partnership or the said partners remained liable at all material times to account to the Union Bank of Switzerland or the Hwa Shih Company for the sums received by the Respondent.
- (4) BECAUSE the liability of the Respondent and the said partnership or the said partners to refund and account for the sums received by the Respondent was an accrued liability immediately enforceable and was not a contingent liability. 40
- (5) BECAUSE any commission or directors' fees received by the Respondent and any dividends received by the Respondent or his wife were paid and received under such a mistake of fact as prevented the recipient acquiring any title to the sums received.

- (6) BECAUSE the said three sums were not trade receipts or profits from any trade or business carried on or exercised by the Respondent or the said partnership or the said partners or any of them.
- (7) BECAUSE, in the alternative, the said sums were profits of a casual and non-recurring nature.
- (8) BECAUSE the determination of the Appellant and the decision of the Board of Review were erroneous in law.
- (9) BECAUSE the reasoning of the Judgment of Mr. Justice Gratiaen in the Supreme Court is well-founded.

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F. HEYWORTH TALBOT.

H. H. MUNROE.

**In the Privy Council.**

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**ON APPEAL**  
*from The Supreme Court of Ceylon*

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**CECIL ALEXANDER SPELDEWINDE,**  
**Commissioner of Income Tax,**  
**Colombo . . . . . Appellant**  
  
AND  
**EMIL SAVUNDRANAYAGAM** *Respondent*

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**Case for the Respondent**

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