FISHER AND SHELMERDINE LTD. v. THE COMMISSIONER OF INCOME TAX.

HIGH COURT CIVIL CAUSE NO. 34 OF 1941.

Income tax—appeal against assessment—leave pay—payment in the nature of salary—directors' fees.

The facts are fully set out in the judgment reported hereunder. Letters have been substituted in the report for figures as the actual figures are of no interest and do not affect the judgment.

Law, C.J.: On the 15th August, 1941, the appellants were assessed to pay income tax for the year 1941–1942 on a chargeable income of £A. This assessment was revised and amended on the 22nd September, 1941, by reducing the amount to £B. Further, on the 23rd September, 1941, the appellants were assessed to pay income tax for the year 1940–1941 on an additional chargeable income of £C.

2. On the 6th October, 1941, the appellants appealed to this Court against the above assessments in respect of the following items:

(*a*) £D, leave pay for Mr. Millar and Mr. Alexander in respect of the years 1939 and 1940.

(*b*) £E, an annual sum paid monthly to Mr. Shelmerdine in respect of 1940.

(c) £F, out of a sum of £G credited to Mr. Shelmerdine as director's fees for 1940 at the annual general meeting held on the 1st February, 1941.

The appellants claim that these amounts are proper deductions to be made from their chargeable income for the periods in question.

3. No date had been fixed for the hearing of this appeal till the 21st January, 1942, when the appellants requested that it should be set down for an early date. The 4th February, 1942, was then fixed. On that date Mr. Warner appeared on behalf of the respondent to apply for an adjournment till the 25th February, on the grounds, principally, that the Commissioner of Income Tax was absent on leave but was expected to return to the Territory on the 9th February, that the Acting Commissioner of Income Tax was fully employed in unexpected additional duties and, consequently, that the Solicitor-General—who was to have appeared on behalf of the respondent—had not been instructed. Mr. Warner added that the Solicitor-General would not be free to attend at Livingstone till the 25th February. The appellants opposed the application on the grounds that Mr. Millar, the appellants' public officer, had arranged to go on leave on the 10th February, and would not return to Livingstone before the 1st April, when Mr. Mills himself, who appears for the appellants, expected to go on leave. Also, Mr. Mills urged the importance of taking Mr. Millar's evidence before the 10th February, in explanation of the points raised. Otherwise, it was pointed out, the appeal could not be disposed of during the present income tax year.

4. It is difficult to appreciate why the Acting Commissioner of Income Tax should expect the Court to give preferential consideration to his other duties rather than to this appeal. The reasons for rejecting the appellants' claim for deductions existed before this appeal was filed. They had been explained by the respondent in correspondence with the appellants. It would seem, therefore, that he should have had no difficulty in instructing one of the Law Officers. A fortnight's notice of the date of hearing of this appeal had been given. It is regrettable that no arrangements were made for the respondent to be represented. This would have involved absence from Lusaka for those concerned for only two working days.

5. To have allowed the application would have caused serious inconvenience to Mr. Millar. I was not satisfied that there were adequate reasons for an adjournment and accordingly refused the application.

6. As regards the appeal itself, the first item to be considered is the £D. This is made up:

£H for 1939.

£J less £K for 1940.

It appears from the evidence of Mr. Millar that the leave arrangements for those, including himself, employed by the appellants' firm were one month in respect of each year's service at a special monthly rate of salary in lieu of the usual rate. The amounts credited for this purpose were:

1939 Mr. Millar £L.

Mr. Alexander £M.

1940 Mr. Millar £N.

Mr. Alexander £O.

Those amounts were duly credited to a Leave Pay Suspension Account and debited to a Salaries and Wages Account after the 31st December, of the year concerned. Mr. Alexander took leave about the middle of December, 1940. As he had been credited with only £M in respect of 1939 he could not draw £O (an increased allowance) in respect of 1940 because he took his leave before the 31st December, 1940. Having drawn the £M in December, 1940, in respect of 1939 the Leave Pay Suspense Account was then debited with that amount and the Cash Account was credited accordingly. Consequently, after the 31st December, 1940, the Leave Pay Suspense Account stood credited with £D. On behalf of the appellants it is argued that though this amount appears as credited to a Suspense Account it is a liability and therefore an expense incurred within the meaning of section 10 (1) Cap. 64 as amended by Ordinance 54/1940. That section, however, speaks of " outgoings and expenses incurred, etc." I am unable to understand how that amount of £D can be regarded as an " outgoing incurred " either in 1939 or 1940. Only the £M paid out in December, 1940, in respect of 1939 was, in truth and in fact, an " outgoing " in 1940. I am unable to agree that any amount whenever credited to Leave Pay Suspense Account is an " expense incurred " notwithstanding it having been debited to Salaries and Wages Account. In my opinion the £D was a *contingent* liability incurred by the appellants, *conditional* on the employees concerned taking leave. If not,

they would be entitled to claim the amounts by way of a bonus and irrespective of their going on leave. Ex. B is the original agreement between the appellants and Mr. Alexander in which it is provided that after the particular period of service therein specified he would be entitled to a particular period of leave and *during his absence on leave* the appellants would pay him a certain sum in respect of and at the end of each month of absence instead of his usual monthly salary. And so I would view the legal aspect. Leave pay is in lieu of and not in addition to salary. Consequently it is a liability *contingently* incurred but not an outgoing or expense *actually* incurred. For the foregoing reasons I reject the appellants' claim that this £D is a permissible deduction.

7. As regards the item of £E. The position as regards the appellants' firm is that there are now three shareholders:

Mr. Millar ...	...	U shares of £1 each.
Mr. Shelmerdine ...		V shares of £1 each.
Mrs. Shelmerdine ...		W shares of £1 each.
		UVW

When Mr. Millar joined the appellants in 1939 as an employee at a salary, Mr. Shelmerdine appears then to have been the sole owner of the firm. It became a private limited liability company that same year. In 1930 Mr. Millar acquired X shares, another Y shares in 1935 and a further Z shares in 1940. Mr. Shelmerdine became very ill in 1933 and had to go to the coast (South Africa) for his health. He was then drawing a salary of £P per annum. In February, 1934, he returned to Livingstone for a short time, and, in consequence of medical advice that he should remain indefinitely at the coast, he agreed to accept the reduced salary of £E per annum. Mr. Millar's salary was then increased and he was made managing director. At that time the shareholders received a return on their shares according to the number of shares respectively held by them. In 1935 it was agreed that the profits should be divided equally between Messrs. Millar and Shelmerdine though Mr. and Mrs. Shelmerdine's aggregate holding of shares was then considerably more than that of Mr. Millar. In 1936 Mr. Millar went on leave and Mr. Shelmerdine came to Livingstone, temporarily, to manage the business and on the same salary £E. On the 3rd June, 1936, a formal agreement was entered into (Ex. A) defining the respective status of those two gentlemen. The substance of that agreement, so far as is relevant to the present issue, was that both Mr. Millar and Mr. Shelmerdine were to receive a salary of £Q per month and that the profits were to be divided in a particular way according to the amount of profit made provided Mr. Shelmerdine continued to hold the shares he then held. That agreement has since expired, but Mr. Shelmerdine still draws £E per annum. In 1940, when Mr. Millar made his last purchase of shares, it was mutually agreed that the profits should be shared as director's fees between him and Mr. Shelmerdine on a fifty-fifty basis. Though Mr. Millar then held U shares and Mr. and Mrs. Shelmerdine VW shares those two amounts were evidently regarded as approximately the same for the purpose of sharing profits. One matter of importance emerges from Mr. Millar's evidence, which is that he

always consults Mr. Shelmerdine in all matters of importance which affect the firm's business. And further, it is an understanding between those two gentlemen that should occasion require the services of Mr. Shelmerdine at Livingstone for a short period then he must come to Livingstone and give those services without extra remuneration. That was also the position in 1940. In these circumstances I have no hesitation in holding that the £E per annum which was and is being paid by the appellants to Mr. Shelmerdine, to the credit of his account at the Standard Bank of South Africa, Ltd., Livingstone, is in the nature of salary for services rendered and was an outgoing and expense wholly and exclusively incurred during the year in question in and on account of the production of the appellants' firm's income. The figure appears to be on the generous side, in view of the actual services now rendered by Mr. Shelmerdine, but his close association, past and present, with the firm must be a valuable contribution to the firm's business status. Consequently, I consider it is a permissible deduction by the appellants from their chargeable income.

8. As regards the £F little need be said. It is unquestionably, together with another £R, exactly half of the £S which is shown as directors' fees in the firm's Profit and Loss Account for the year ending the 31st December, 1940. The very history of these monies shows, that instead of paying profits as dividends according to the shares held by the shareholders those profits are divided equally though described as directors' fees. Consequently, I do not regard this amount £F as a permissible deduction. The other £R above mentioned has been allowed by the respondent as directors' fees for Mr. Shelmerdine. This allowance is inconsistent. It is no more a permissible deduction than the £F. It is an undercharge and accordingly is disallowed together with the £F. I have been referred to the case of *Aspro, Ltd.* v. *Commissioner of Taxes* (1932, A.C. p. 683) in support of the appellants' action of voting profits as directors' fees at their annual general meeting on the 1st February, 1941. But I do not consider that decision can be applied to this particular issue, first, because I have not been shown the appellants' Articles of Association and, secondly, in the absence of such authority, it is inaccurate to describe profits as directors' fees. Incidentally, Mrs. Shelmerdine renders no services to the appellants' firm. She holds W shares. Can it be reasonably suggested that directors' fees and not profits were paid in respect of her holding ?

9. For the purposes of income tax it is immaterial how income or expenditure is dealt with or described in books of accounts. What is of importance is the real nature of a debit or credit or of a receipt or an expenditure, and (for the purposes of section 10 (1) and (2) Cap. 64, as amended by Ordinances 54 of 1940 and 5 of 1941) whether it is permissible to deduct such debits or expenditure as outgoings and expenses wholly and exclusively incurred inside or outside the Territory during the year preceding the year of assessment by such person in the production of the income.

10. In the result I find and so hold that the sums of £D and £G were part of appellants' chargeable income, but that the sum of £E was a permissible deduction and not so chargeable. Accordingly, I reduce the amount of the assessment for the periods in question by £T.

11. As regards costs of this appeal, they are in the discretion of the Court. The appellants have succeeded on one (the major) item out of three. The hearing of the appeal occupied nearly five hours. I fix the appellants' costs at £15 15s.