IN THE COURT OF APPEAL FOR EAST AFRICA

AT NAIROBI

(Coram: Wambuzi P, Mustafa & Musoke JJ A)

(CIVIL APPEAL NO 7 OF 1976

COMMISSIONER OF INCOME TAX …….APPELLANT

VERSUS

LEREMATESHO LTD……RESPONDENT

JUDGMENT

This is an appeal by the Commissioner of Income Tax against the decision of the High Court of Kenya in an assessment of income tax raised against the taxpayer company in respect of the year of income 1971. The taxpayer is a limited liability company incorporated in 1957 for the purpose of purchasing and carrying on the business previously carried on by Colvile and Lady Delamere. It is the commissioner's case that in 1971 the taxpayer in course of business purchased and resold shares and stocks from various companies and made a profit of £6341 and was accordingly assessed to income tax on that amount. In his statement of facts the commissioner referred to the following two clauses in the memorandum of association of the taxpayer company stating some of the objects of the company:

3. To carry on any other business which may seem to the company capable of being conveniently carried on in connection with the foregoing or calculated directly or indirectly to enhance the value of or render more profitable any of the company's property or rights. To take or otherwise acquire and hold shares in any other company having objects altogether or in part similar to those of this company or carrying on any business capable of being conducted so as directly or indirectly to benefit this company …The objects set forth in any sub-clause of this clause shall not except when the context expressly so requires be in any wise limited or restricted by reference to or inference from the terms of any other sub-clause or by the name of the company. None of such sub-clauses or the objects therein specified or the powers thereby conferred shall be deemed subsidiary or auxiliary merely to the objects mentioned in the first sub-clause of this clause but the company shall have full power to exercise all or any of the powers conferred by any part of this clause in any part of the world and notwithstanding that the business, undertaking, property or acts proposed to be transacted, acquired, dealt with or performed do not fall within the objects of the first sub-clause of this clause.

The purchases and sales of the shares and stocks in 1971 were therefore the carrying on of trade or business in shares pursuant to these very wide objects of the taxpayer company.

The taxpayer company admitted the purchases and sales of the shares and stocks but claimed that its main business was farming and the purchases were investments of moneys not immediately required for the farming business, that the sales were a realisation of those investments and that therefore any profits arising therefrom were not taxable. In its statement of facts the taxpayer referred to the objects of the company particularly the following:

(a) Clause 3(a) and (b) of the memorandum and article 2, which show that the main object for which the respondent was established was the acquisition and continuation of a specified farming business;

(b) Clause 3(p) of the memorandum. which authorized investment of moneys not immediately required, and which was the only power in exercise of which the respondent has in fact invested certain moneys in stocks and shares;

(c) The absence of any other express provision for investment in stocks and shares, except shares in companies having similar objects (as provided by clause

3(n) of the memorandum); and (d) Article 41, which, by expressly allowing the dividend on shares purchased cum dividend to be treated as revenue impliedly precluded the treatment of profits on sales of shares as revenue.

The Nairobi local committee to which the commissioner first appealed found in favour of the taxpayer and the High Court confirmed the decision of the local committee. It is against this decision that the commissioner now appeals to this Court listing no less than nine grounds of appeal in his memorandum of appeal.

The question before Chesoni J, and indeed before us, is whether or not at the material time the purchases and sales of the shares and stocks amounted to carrying on a business or trade of dealing in shares. If so, then, under section 3 of the East African Income Tax Management Act, then in force, the taxpayer company would be liable to pay income tax on the profits resulting from the sales. The relevant part of the section provided: Tax shall, subject to this Act, be charged for each year of income upon the income of any person which accrued in or was derived from the partner States in respect of :

(a) gains or profits from -

(i) any business, for whatever period of time carried on; ... and by section 2 of the same Act the expression “business” includes Any trade, profession or vocation.

The judge dealt with the issue in this case as follows: In the present case there was no evidence before the Court to show that the [tax-payer company] purchased the shares with a view to resale. In fact Mr Salter strongly contended that the shares were bought as an investment of the [taxpayer company] with the company’s moneys not immediately required, and, that the profit from resale of the said shares was not trading profit but capital gain. This claim was not seriously contradicted by the commissioner. The local committee, it seems, accepted the view that the shares were purchased as an investment and their sale was merely realisation of that investment.

As stated earlier, since 1967 the [taxpayer company] has been buying and selling shares, and profit, though small, was made in the years prior to 1971. The [commissioner’s] failure to raise assessment on the profit made from the sale of shares made in the years prior to 1971 raises a presumption that he did not treat such profit as trading profit subject to income tax, but accepted the [taxpayer company’s] case that the profit from sale of the shares was capital gain. For the [commissioner] to succeed, therefore, he

must show that some time later, in some manner, by some operation or other, the object of buying shares as an investment of the [taxpayer] company's moneys not immediately required was reversed and the intention fundamentally altered ...

The Principal State Counsel argued that the taxpayer whose original intention was investment may change his intention or form a subsequent intention to trade or carry on business. That I agree with, but for the Court to infer a change of or subsequent intention from investment to trade the party alleging the change of the original or subsequent intention must place before the Court facts and or circumstances to warrant such inference. In the case before me the facts seem to show that the Commissioner of Income Tax accepted that the [taxpayer] company had bought shares in various companies for investment purposes. This is supported by the fact that although the [taxpayer] company has been buying and selling shares since 1967, no assessment was raised on the profits made from the sale of the shares, except the profits made in 1971. Maybe before the commissioner raised the assessment on profits made in 1971 year of income he had evidence that the original purpose to hold the shares as investment, which the [taxpayer company] claims was the purpose for which the shares were bought, had changed. If so, I have not been favoured with those facts by the appellant. The [taxpayer] company has all along maintained that the shares were purchased as investment of the [taxpayer] company's moneys not immediately required, and this point has not been seriously challenged by the [commissioner] ....

The local committee in the present case found that shares were not purchased for the purpose of profitmaking. They were entitled to do so. The [commissioner] has adduced no new or any facts, apart from arguing the case, to induce me differ from the finding of the local committee. Now, on what facts can I hold that a company which had not purchased shares for the purpose of profit-making by sale of those shares was enganged in the business of selling shares and not merely realising the shares when all the [taxpayer] company had done was to realise the shares to the best advantage" The principles which the Court applies in ascertaining whether profits made on sale are taxable or not are those laid down in the case of *Californian Copper Syndicate Ltd v Harris* (1904) 5 TC 159 which has been applied in Kenya …

Applying these principles to the present case and being satisfied that the original intention of the [taxpayer] company in purchasing the shares was to invest the company's moneys not immediately required, which original intention has not changed, I find that the sale of the shares was not an operation of trade and or business for profit- making. The sale of the shares was merely realising of an investment to the best advantage. Accordingly the profits from the sale of the shares held by the [taxpayer] company in various companies are not liable to income tax.

The main ground of appeal is that the judge misdirected himself on the onus of proof. Mr da Silva for the commissioner submitted that the judge accepted that the taxpayer company had discharged the burden on it of proving that the assessment was excessive before the local committee and failed to assess and evaluate the evidence in this case. Having accepted this position the judge went on to hold that the commissioner had adduced no new facts to induce him to differ from the finding of the local committee. Counsel suggested that for the same reason the judge had rejected a request by counsel for the taxpayer company to call two witnesses, one to explain the investments and the other the meaning of some article in the memorandum of association.

Secondly, counsel argued that the judge erred in holding that there was no evidence to show that the original purpose to hold the shares as an investment had changed. He submitted that in 1971 there were frequent and systematic purchases and sales of shares which in themselves would show a change in the original intention.

I think there is considerable merit in these submissions. In the first place it is common ground: (1) that the main business of the taxpayer company is farming; (2) that the original intention in purchasing shares by the taxpayer company was to hold such shares as an investment; (3) that whether a trade or business has been carried on is a question of fact; and

(4) that the onus is on the taxpayer to show that the assessment objected to is excessive.

Under section 103(d) of the East African Income Tax Management Act a judge on appeal may confirm, reduce, increase or annul the assessment or make such order thereon as he may think fit. It would appear therefore that the judge has to weigh and evaluate the evidence and draw his own conclusions irrespective of any findings of the local committee. In the words of this Court in *O v Commissioner of income Tax,* 1 EATC 125: The High Court is obliged, regardless of any findings of the committee, to approach every issue of fact as *res integra*, and to make its own findings thereon, and that in so doing it is bound by the provision that the onus is always on the taxpayer to show that the original assessment was excessive.

In agreement with Mr da Silva I find that the judge quite properly directed his mind to the law applicable in this case but, except at the conclusion of his judgment (and I shall be coming to this later), made no finding of fact to resolve the issue before him. Instead he referred to the findings of fact by the local committee and without any indication of his agreement therewith or acceptance thereof referred to cases in support. Mr Salter for the taxpayer company submitted that reading the judgment as a whole it is clear that the judge agreed with the findings of fact of the local committee. I do not agree. On the question of the burden of proof, the judge said:

Mr Salter submitted that the onus of proof was discharged before the local committee. There is much force in Mr Salter's submission, and there was no challenge to this submission.

As Mr da Silva pointed out, the fact that the commissioner had appealed was in itself a challenge to that finding. In any case what mattered at that stage was not the local committee's finding, but the court's finding. The judge then considered a number of authorities but did not say whether he was satisfied that the taxpayer company discharged the burden on him. On the question whether the original purchases of shares were an investment as claimed by the taxpayer company, the judge said:

This claim was not seriously contradicted by the commissioner. The local committee, it seems, accepted the view that the shares were purchased as an investment and their sale was merely realisation of that investment. On the question whether the shares in question were purchased for the purpose of profit-making, the judge said:

The local committee ... found that shares were not purchased for the purpose of profit-making. They were entitled to do so. The [commissioner] has adduced nonew or any facts, apart from arguing the case, to induce me differ from the finding of the local committee. Here again the judge did not say whether the local committee's finding of fact was correct or not.

As regards the original intention the judge said: While [the commissioner's counsel] admits that the original intention of the [taxpayer company] was to make a capital investment, he suggests that facts of the case give rise to an inference of change of or a subsequent intention making the [taxpayer] company's venture in the nature of trade or business in shares.

I am unable to find on the record any such admission. However, Mr da Silva, probably relying on the judgment, conceded that this was so. The question, then, is whether or not there was a change or a

subsequent intention to deal in shares as a business on the part of the taxpayer company. On this question Mr Salter submitted that there was no evidence that the original intention of holding the shares as an investment had changed. He said that there was a distinction between proving an excessive assessment, the onus to do so being on the taxpayer, and proving a change in intention, the onus for which is on the commissioner. He argued that otherwise the taxpayer had to prove the negative that there was no change in intention. I am not persuaded by this argument as, on the face of it, it suggests that the commissioner should prove the negative that the assessment is not excessive as there was a change in intention. As this Court put it in the *Commissioner of Income Tax v NE Bapoo*, 2 EATC 397:

The onus is on the taxpayer to establish that a particular transaction is of a capital and not a revenue nature if he seeks thereby to avoid liability for tax.

I accept, however, that where the original intention is established there must be evidence to show that there was a change; but I do not think that this in any way throws any burden of proof on the commissioner. Accordingly, it was a misdirection on the law for the judge to say that in order for the appellant to succeed he had to show:

That some time later, in some manner, by some operation or other, the object of buying shares as an investment of the [taxpayer] company's moneys not immediately required, was reversed and that intention fundamentally altered.

This would cut across the provisions of section 103(c) of the East African Income Tax Management Act by shifting the burden of proof to the assessor to prove in effect that the assessment was not excessive. Apparently the judge had in mind *Dunn Trust Ltd v Williams* (1950) 31 TC 477. The words used by Vaisey J were correctly quoted by the judge and I set out the relevant part which reads:

The finding that these stocks or shares had been purchased with that object seems to me to be a finding which, in order to justify the conclusions of the commissioners, must have been followed by a further finding that at some time, in some manner, by some operation or other, the object had been reversed and the intention fundamentally altered.

As the judge pointed out, the Court found in that case that there was no evidence to support the commissioner's action. I doubt if this means that the commissioner had to prove that there was a change of intention. In any case *Williams* case is distinguishable from the present case. In the very next sentence to the passage quoted above Vaisey J said:

So far I have found it very difficult to discover upon what the commissioners can have based the decision that the realisation of these shares produced profits out of the trading of the company. Then, when I look at the statement of the sales which resulted in producing the profits which have been held to be the subject of tax, I find, as I have already stated in passing, explanations given as to why and how and for what purpose these shares were sold; and I find that the purposes indicated are quite inconsistent with the purposes which should animate those who direct the fortunes of a trading company when they are effecting sales of that company's stock-in-trade, be it investments or be it any other kind of property, because I find that the commissioners go out of their way to state, not that the securities were disposed of in the ordinary course of business or because they thought that would produce a desirable profit, or because they thought that it was a trading operation which was financially beneficial to the company; but I find the statement that they were disposed of under the circumstances which are set out in the case.

I think it is not necessary to go into the circumstances of that case but at this stage one may ask what explanation is there in the present case as to why, how and for what purpose the taxpayer company

bought and sold the shares in 1971" None, except the claim that the shares were sold to realise the investments to the best advantage. This would perhaps explain the sales; but what about the purchases" The case for the commissioner as I understand it is that the taxpayer company frequently and systematically purchased and sold shares. The table attached to the statement of facts by the respondent company shows the number of transactions as follows:

NB Number of Transactions

Purchases Sales

68 7 4

69 4 4

70 15 5

71 9 7’

On the argument of the taxpayer company, the position seems to be that the taxpayer company bought shares as an investment of moneys not immediately required for the farming business. It sold shares to realise the investments to the best advantage, which incidentally perhaps released more funds which were not immediately required for the farming business; and shares were bought to invest the unrequired funds. The judge quite properly in my view directed his mind on the law when he said:

Where a company which is authorised by its articles of association to deal in a venture deals in that venture, *prima facie*, there is a rebuttable presumption that the company is carrying on a business or trade in that venture. The taxpayer may rebut that presumption by showing that the article, the subject-matter of the transaction, was not acquired for the purpose of trade or profit-making. In the instant case the same memorandum of association that authorises the [taxpayer company] to deal in shares also authorises it to invest the company’s moneys not immediately required.

This was not a single purchase and resale of the shares. It was a scheme over a number of years which resulted in considerable profits in the year in question. No evidence whatsoever was called to rebut the presumption and, as mentioned earlier in this judgment, the proposed evidence to explain the investments was rejected as unnecessary by the judge. In these circumstances I am unable to appreciate that the sales were only a realisation to the best advantage of the investments. This explanation is certainly not inconsistent with the purposes, which should animate those who direct the fortunes of a trading company. There was no evidence, for example, to show that there was any threat to the value of the shares which prompted the taxpayer company to sell in order to protect the investments by averting a loss and to buy other shares which were more secure. As the judge agreed- “It is not what business does the taxpayer profess to carry on but what business does he actually carry on.” The taxpayer company has very extensive powers over a wide range of objects.

If this is the usual thing then the company should explain the boundaries of its activities. I would not say either that the absence of special staff to do the speculation or the accounting procedure adopted by the taxpayer company would in the circumstances of this case delimit the boundaries of the taxpayer company’s activities. This Court appears to have accepted that if the facts of a case warrant an inference, it can be held that even if the original purpose was to acquire an investment, the owner changed his intention and decided to utilise the asset in trade. Having regard to the objects of the taxpayer company, the frequencies of the purchases and sales, the magnitude of the transactions, the

magnitude of the advantage on the sales and the explanation of the taxpayer company, I am left in no doubt that had the judge properly directed his mind to the issue, he would have come to the conclusion that the taxpayer company was dealing in shares as a business. The judge said that the commissioner over the years had accepted that the taxpayer company bought and sold shares for investment purposes because he raised no assessment on the profits until 1971. That may be so but I understand the commissioner's case to be that it was that system of purchases and sales which induced him to raise the assessment in question as it was clearly in the nature of trade. In my view the commissioner was entitled to look at the evidence as a whole in order to decide whether or not the subsequent purchases and sales of shares over the period in question amounted to the carrying on of a trade in shares. In any case I doubt if the commissioner's views would alter the nature of the transactions.

I agree with Mr Salter that this Court will not normally disturb a finding of fact by a trial judge unless there was a misdirection in law or the wrong principles were applied. In this case, however, the judge did not make any finding of fact. He relied on the findings of fact by the local committee and reached the conclusion that he was satisfied:

that the original intention of the [taxpayer] company in purchasing the shares was to invest the [taxpayer] company's moneys not immediately required, which original intention has not changed. which as far as I can see is the only finding of fact he made but which, with respect, was based on wrong principles as already indicated in this judgment.

I would allow the appeal with costs here and in the High Court and restore the assessment as prayed by the appellant commissioner.

Mustafa J A. I have read the judgment prepared by Wambuzi P and agree with the order he proposes. I will briefly state my views on this appeal. The taxpayer company was incorporated with the main object of stock, dairy and produce farming of all kinds, but it also had other objects including those of acquiring and holding shares in any other company having similar objects to it and of carrying on any other business calculated directly or indirectly to render profit to the taxpayer company. There was also an objects clause to the effect that none of the sub-clauses after the first sub-clause shall be deemed subsidiary or auxiliary to the first subclause, which concerned farming. The taxpayer company, since 1967, has been purchasing and selling shares. It was submitted on behalf of the taxpayer company that it was investing its money not immediately needed in the purchase of shares, that is to say, the shares were purchased for investment purposes.

The company was assessed to tax on its income from farming, but in 1971 the appellant (hereafter called the commissioner) for the first time also assessed the taxpayer company to tax on the profits it made on the sale of its shares.

The taxpayer company appealed against the commissioner's assessment on its profits from sales of shares to tax to the local committee which upheld its objection, and on further appeal, the High Court (Chesoni J) upheld the local committee's decision. The issue in this appeal before us is a short one, which is, whether the sale of shares by the taxpayer company in 1971 was in the nature of trade, in which case it would be taxable, or in the nature of capital realisation, in which case it would not be.

Certain matters are not in dispute between the parties. The taxpayer company made a profit of £6341 on the sale of shares in 1971. The onus of proof relating to an excessive assessment lies on the person assessed: see section 103(c) of the East African Income Tax Management Act (hereinafter referred to as "the Act"). "Trade" includes every trade, manufacture, adventure or concern in the nature of trade; and "business" includes any trade, profession or vocation. The number of transactions concerning share

dealings by the company for a period of four years are as follows:

Purchases Sales

1968 7 4

1969 4 4

1970 15 5

1971 9 7

The first appellate judge correctly directed himself on the onus of proof when he stated “It is the law that the burden of proof relating to an excessive assessment lies on the person assessed”. However, he went on: Mr Salter submitted that the onus of proof was discharged before the local committee. There is much force in Mr Salter’s submission and there was no challenge to this submission.

In another part of his judgment, he said:

As stated earlier, since 1967 the [taxpayer] has been buying and selling shares, and profit, though small, was made in the years prior to 1971. The [commissioner’s] failure to raise assessment on the profit made from sale of the shares in the years prior to 1971 raises a presumption that he did not treat such profit as trading profit subject to income tax, but accepted the [taxpayer company’s] case that the profit from sale of the shares was capital gain. For the [commissioner] to succeed, therefore, he must show that some time later, in some manner, by some operation or other, the object of buying shares as an investment of the [taxpayer] company’s money not immediately required, was reversed and the intention fundamentally altered.

From these passages it seems to me that the first appellate judge held that since the local committee was satisfied that the assessment was excessive, he would accept that finding without any further enquiry of his own and that it was for the commissioner to satisfy him that the taxpayer company had altered its intention; that is, it had changed from capital investment to trading in shares. Mr Salter for the taxpayer company has strenuously argued that the first appellate judge did not merely adopt the local committee’s finding but came to a conclusion of his own and in the circumstances it was for the commissioner to prove change of intention as the taxpayer company could not prove a negative. With respect I am unable, from a careful reading of the judgment, to find that the first appellate judge had himself analysed and evaluated the evidence and come to the conclusion that the taxpayer company had satisfied him that the assessment was excessive: see *O v Comissioner of Income Tax,* 1 EATC 124, at 128. He only referred to such a finding made by the local committee and proceeded on that assumption. Since the first appellate judge did not himself find that the assessment was excessive, there was no question of the commissioner having to prove any change of intention on the part of the taxpayer company as the onus of establishing that the assessment was excessive was on the taxpayer company. I am in agreement with the two main grounds of appeal submitted by Mr da Silva for the commissioner, (1) that the first appellate judge erred in failing to approach the issues raised in the appeal before him as *res integra*, and (2) that he erred in placing the onus of proof on the commissioner to show that there was a change of intention on the part of the taxpayer company.

In my view, this Court will have to make a finding on the evidence before it as to whether the sale of shares was, or was not, in the nature of trade. I will accept that originally the taxpayer company bought shares as an investment. Once the commissioner assessed the taxpayer company to tax on its sale of

shares, then the onus of proving that the assessment was excessive was on the taxpayer company: section 103(c) of the Act. I cannot agree with the first appellate judge that the commissioner's failure to assess tax on such sales prior to 1971 would give rise to a presumption in favour of the taxpayer company, so much so, that the onus of establishing a change of intention would shift to the commissioner. The fact of assessment itself places on a taxpayer the burden of proving that it was excessive. Indeed, if on the evidence the taxpayer can only show that the conflicting views are equally balanced, then the taxpayer would have failed to discharge that onus.

What are the facts here" From a study of the table of sales and purchases for the four years 1968 to 1971 it would seem that the taxpayer company was systematically buying and selling shares. It was empowered by its objects to do so as part of its business. It is possible that the taxpayer company was safeguarding its capital by buying and selling shares, but it is equally if not more possible that it was dealing and trading in shares.

No evidence was given by any witness as to the state of the shares bought and sold in 1971, why certain shares were bought and why some were sold. If it was the case of the taxpayer company that certain shares had to be sold to forestall depreciation of their value, then evidence to that effect had to be adduced. None was given. The variations in investments, the frequency, nature and magnitude of the transactions and the amounts of profits made could constitute grounds for holding that the original intention in 1967 of buying shares as an investment had changed to trading in shares.

The commissioner did in effect so hold and assessed the taxpayer company to tax on its profits on sales of its shares during 1971. It was then for the taxpayer company to establish that it bought and sold its shares in 1971 as a capital investment or in protection of its capital assets and that the profits constituted a capital gain. In my opinion the taxpayer company did not discharge that burden, and the commissioner's appeal must succeed.

Appeal allowed.

Dated at Nairobi this 31st day of May 1976.

S.W.W.WAMBUZI

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PRESIDENT

A.MUSTAFA

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JUDGE OF APPEAL

J.S. MUSOKE

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JUDGE OF APPEAL