

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. BR 2/77

Board of Review:

S. V. Gittins, *Chairman*, Alexander S. K. Au, P. G. Willoughby & David C. S. Wu, *Members*.

3rd March 1978.

Profits tax – taxpayer acquiring shares by way of exchange – whether the market value of its shares issued at the date of exchange is the real cost to itself of the shares so acquired.

In September 1972 the taxpayer, a public company, commenced its business in dealing in land and shares. Between the period 17/1/73 and 8/3/73 it acquired shares in 3 public companies in exchanges of its new shares for shares of those companies. The shares so acquired and the taxpayer's shares issued in respect of the 3 share exchange transactions were recorded at par value in the taxpayer's accounts and in its balance sheet dated 30th June 1973, at which date the acquired shares were still unsold.

For the year of assessment 1972/73 the taxpayer first submitted a profits tax return showing assessable profits of over \$14,000,000 calculated on the basis of the par values of the acquired shares of the 3 companies and its shares issued to the companies. Subsequent to this, the taxpayer made a claim for the loss in the market values of the quoted investments in the shares held in the 3 companies, the loss which amounted to over \$66,000,000 was computed by aggregating the differences between the market values of the shares of each of the companies on the date of the relative exchange and the market values of those shares as at the 31st March 1973. A revised computation for the year of assessment 1972/73 was submitted showing a loss of over \$31,000,000. The claim was not accepted and the assessable profits of the taxpayer were computed on the basis of its initial return.

On appeal it was contended for the taxpayer that where there had been a share exchange transaction the taxpayer was entitled, for the purposes of profits tax, to take the market value of its shares on the date of the shares exchange agreement as the real cost to itself of the shares acquired in exchange and that the difference between real cost and the market value as at 31st March 1973 of the shares acquired should be allowed as loss for tax purposes.

Decision: Appeal allowed. Assessment amended to accord with the real cost of investments per market value of taxpayer's shares issued at day of exchange.

Peter Rees, Q.C. and Robert G. Kotewall for the appellant.

H. J. Somerville, Senior Crown Counsel, for Commissioner of Inland Revenue.

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Cases referred to:-

1. Whimster & Co. v. C.I.R., 12 T.C. 813.
2. Craddock v. Zevo, 27 T.C. 267.
3. Seaham Harbour Dock Co. v. Crook, 16 T.C. 333.
4. Odeon Associated Theatres v. Jones, (1972) 2 W.L.R. 331.
5. Gold Coat Selection Trust Ltd. v. Humphrey, 30 T.C. 209.
6. Murphy v. Australian Machinery & Investments Co. Ltd., 30 T.C. 244.

Reasons:

1. The Taxpayer Company is a public company and its objects include dealing in land and shares.
2. By a Prospectus dated the 23rd August 1972, 20,000,000 shares of \$2.00 each were offered for public subscription at \$5.00 per share. The offer was fully subscribed. The premium of \$60,000,000 (\$3.00 per share) was carried to a Capital Reserve account. At the 30th August 1972 the issued share capital of the Taxpayer was \$160,000,000 comprising 80,000,000 shares of \$2.00 each fully paid.
3. The Taxpayer commenced business on 8th September 1972, which was the date of the first acquisition of quoted shares and also the date of first interest income.
4. At a meeting of the Board of Directors of the Taxpayer held on the 17th January 1973, it was resolved to approve an agreement whereby A Company would allot to the Taxpayer 2,500,000 new shares of \$2.00 each, in exchange for the allotment by the Taxpayer to A company of 2,000,000 new shares of \$2.00 each.
5. The relevant part of the Return of Allotment in respect of this transaction presented by the Taxpayer's solicitors was as follows:

“Number of shares allotted payable in cash	Nil
Nominal amount of shares so allotted	Nil
Amount paid or due and payable on each share	Nil
Number of shares allotted for a consideration other than cash	2,000,000
Nominal amount of shares so allotted	\$2.00
Amount to be treated as paid on each such share	\$2.50

The consideration for which such shares have been allotted is as follows:-
Form I attached”.

The relevant part of Form I was as follows:-

“Particulars of contract relating to shares allotted as fully or partly paid up otherwise than in cash by the Taxpayer.

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(1) The number of shares allotted as fully or partly paid up otherwise than in cash	2,000,000
(2) The nominal amount of each such share	\$2.00
(3) The amount to be considered as paid on each such share otherwise than in cash	\$2.50
(4) If the consideration for the allotment of such share is services, or any consideration other than that mentioned below in part 5, state the nature of such consideration, and the number of shares so allotted	Consideration: 2,500,000 shares of \$2.00 each in the capital of A company.

See copy Agreement attached.”

6. At a meeting of the Board of Directors of the Taxpayer held on 23rd February 1973, it was resolved to enter into an agreement with B company, whereby B company would allot to the Taxpayer 2,200,000 shares of \$2.00 each, in exchange for the allotment by the Taxpayer to B company of 2,200,000 shares of \$2.00 each.

7. The relevant part of the Return of Allotment presented by the Taxpayer was as follows:-

“Number of shares allotted payable in cash Nil
 Nominal amount of shares so allotted Nil
 Amount paid or due and payable on each share Nil
 Number of shares allotted for a consideration other than cash 2,200,000
 Nominal amount of shares so allotted \$2.00
 Amount to be treated as paid on each such share \$2.00
 The consideration for which such shares have been allotted is as follows:-

<i>Name</i>	<i>Address</i>
B company	North Point, Hong Kong.

<i>Description</i>	<i>No. of shares allotted</i>
Corporation	<u>2,200,000”.</u>

8. At a meeting of the Board of Directors of the Taxpayer held on 8th March 1973, it was resolved to enter into an agreement with C company, whereby C company would allot to the Taxpayer 2,000,000 shares of \$1.00 each, in exchange for the allotment by the Taxpayer to C company of 880,000 shares of \$2.00 each. In the minutes, it is recorded that the Taxpayer’s shares are to be issued at the price of \$25.00 per share and those of C company at \$11.00 per share.

9. The relevant part of the Return of Allotment for this transaction was as follows:-

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“Number of shares allotted payable in cash	Nil
Nominal amount of shares so allotted	Nil
Amount paid or due and payable on each share	Nil
Number of shares allotted for a consideration other than cash	880,000
Nominal amount of shares so allotted	\$2.00
Amount to be treated as paid on each such share	\$25.00
The consideration for which such shares have been allotted is as follows:-	

<i>Name</i>	<i>Address</i>
Hang Seng (Nominees) Limited.	77 Des Voeux Road Central, Hong Kong.

<i>Description</i>	<i>No. of shares allotted</i>
Corporation	<u>880,000</u> ”.

For the avoidance of doubt we note that the consideration passing to the Taxpayer was in fact 2,000,000 shares in C company. It was conceded by the Taxpayer that the figure of 880,000 shares entered in the particulars of the consideration was an error.

10. The shares allotted by the Taxpayer for its part in the 3 exchange transactions were recorded in its accounts as having been issued at par. None of these 3 lots of shares acquired by exchange had been sold by 30th June 1973, the date of the Taxpayer’s Balance sheet, and these acquired shares were also recorded in the Taxpayer’s accounts at the par value of its own shares issued in exchange. In the Balance Sheet the acquired shares were included at such par values, under the heading “Quoted Shares, at Cost”.

11. The Company’s Profits Tax Return for the year of assessment 1972-73 was submitted on 7th June 1974. It showed an assessable profit of \$14,028,247 for the year, which was computed as follows:-

Year of Assessment 1972-73
Section 18(3): Basis Period 8.9.72 to 31.3.73

Profit per Profit & Loss Account for the period ended 30.6.73		\$54,488,926
<i>Additions:</i> Dividend Expenses, say	\$5,000	
Donation not claimed	<u>2,000</u>	<u>7,000</u>
		\$54,495,926
<i>Deduct:</i> Dividend Received from Investment		<u>34,240,505</u>
Adjusted Profits		<u>\$20,255,421</u>
Profits for the Basis Period 205/296 of \$20,255,421		<u>\$14,028,247</u>

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12. On 23rd July 1974, one and a half months' later, the Taxpayer through its Representatives wrote to the Assessor to make a claim for the loss in market value of the quoted investments in the shares held in A, B and C companies, computed by them at \$66,020,000. This figure was arrived at by deducting from the cost of the shares valued at market value on the date of each exchange agreement, the alleged market value of the shares at 31st March 1973. In line with this claim, a Revised Computation for the year of assessment 1972-73 was submitted, showing a loss of \$31,688,137, computed as follows:-

<i>Year of Assessment 1972-73</i>		
<i>Section 18(3): Basis Period 8.9.72 to 31.3.73</i>		
Profit per Profit & Loss Account for the period ended 30.6.73		\$54,488,926
<i>Additions:</i> Dividend Expenses, say	\$5,000	
Donation	<u>12,000</u>	<u>17,000</u>
		\$54,505,926
<i>Deduct:</i> Dividend Received	\$34,240,505	
Loss in Market Value of Quoted Investments	<u>66,020,000</u>	<u>100,260,505</u>
Adjusted Loss		<u>\$45,754,579</u>
Loss for the Basis Period 205/296 of \$45,754,579		<u>\$31,688,137</u>

13. The Assessor did not accept the loss claimed in respect of the shares in A, B and C Companies and on 25th July 1975 he raised Profits Tax assessment for the year of Assessment 1972-73 in the amount of \$14,033,788 on the basis of the return in paragraph 11 above.

14. The Taxpayer through its Representatives lodged an objection against this assessment (as well as against the assessments for the 2 following years). The Commissioner determined the objection against the Taxpayer, insofar as it related to the claim of the loss in market value of the shares held in A, B and C Companies. From this determination the Taxpayer has appealed to the Board of Review.

15. The sole issue in this appeal is the cost to the Taxpayer for profits tax purposes of the shares acquired on exchanges of shares with A, B and C Companies.

16. For the Taxpayer it was contended that the cost was either the closing stock exchange quotations for the Taxpayer's shares on the day on which each of the share exchange

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agreements were executed, multiplied by the number of shares allotted, alternatively the quotation for the shares acquired multiplied by the number of shares acquired. The relevant closing stock exchange quotations are as follows:-

17/1/73 Taxpayer's shares \$15.70; A shares acquired,	\$18.70.
23/2/73 Taxpayer's shares \$27.20; B shares acquired,	\$27.60.
8/3/73 Taxpayer's shares \$25.00; C shares acquired,	\$10.90.

17. At the hearing the Taxpayer put in a revised statement of its claim for loss in market value of the 3 share exchange transactions for tax purposes as follows:-

ADJUSTMENT OF INVESTMENTS COST FOR TAX PURPOSES AT DATE OF EXCHANGE AGREEMENTS

<i>Date</i>	<i>Book Cost of Investment per Par Value of Shares issued</i>	<i>Real Cost of Investments per Market Value of Shares issued at day of exchange</i>	<i>Market Value of Investment at 30.6.73</i>
17/1/73 2,000,000 shares in Taxpayer at \$15.70 exchange for 2,500,000 shares in A Company	\$ 4,000,000	\$ 31,400,000	\$19,500,000
23/2/73 2,200,000 shares in Taxpayer at \$27.20 exchange for 2,200,000 shares in B Company	4,400,000	59,840,000	16,280,000
8/3/73 880,000 shares in Taxpayer at \$25.00 exchange for 2,000,000 shares in C Company	<u>1,760,000</u>	<u>22,000,000</u>	<u>4,400,000</u>
	<u>\$10,160,000</u>	<u>\$113,840,000</u>	<u>\$40,180,000</u>

Difference between Real Cost and Market Value of these investments amounting to \$73,660,000 should be allowed as loss for tax purposes.

18. The Commissioner, in his reasons for rejecting the objection, made the following points:-

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- (a) The Profit or Loss on the shares, which were admittedly trading stock, is the difference between what they cost the Taxpayer and what they were sold for, subject to normal adjustments for the value of undisposed shares at the end of the accounting period.
 - (b) The cost of the shares has been clearly and unambiguously shown in the Taxpayer's accounts as the fully paid up par value of the new shares issued by the Taxpayer.
 - (c) The accounts have been certified true and correct by the Directors of the Taxpayer and its auditors.
 - (d) The claim that the true cost of the shares acquired is their market values on the day of the respective agreements is unaccompanied by any admission by the Taxpayer that the accounts were in anyway incorrect or that the treatment in the accounts was in any way colourable or fraudulent.
 - (e) It is agreed that "cost" for accounting purposes and "cost" for tax purposes may be different, e.g. there could be a difference of opinion on matters such as bringing overheads into account when computing cost. But this is not one of those cases.
 - (f) The Taxpayer was entitled to issue the shares at par, below par or above par, and has issued them fully paid up at par.
 - (g) The price paid by the Taxpayer for the assets acquired is prima facie the nominal value of the issued shares and it is for the Taxpayer to establish the contrary. This it has failed to do.
 - (h) The Returns of Allotment made under the Companies Ordinance which might have afforded some evidence of costs, are in conflict with both the Taxpayer's accounts and the subsequently submitted tax computation, and must be discounted.
19. The propositions put forward by Mr. Peter Rees, Q. C. on behalf of the Taxpayer are:-
- (a) That the profits or losses on the 3 transactions are to be determined in accordance "with the ordinary principles of commercial accounting, so far as applicable, and in conformity with the rules of the Income Tax Act" per the Lord President (Clyde) in **Whimster & Co. v. C.I.R.**¹.
 - (b) There is nothing in the Hong Kong Ordinances to displace these principles.
 - (c) The treatment of the transactions in the Taxpayer's accounts and other relevant documents does not determine its profits or losses for tax purposes.

¹ 12 T.C. 813 at p. 823.

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- (d) In arriving at profits or losses according to accepted commercial accounting principles, the Board will be assisted by the evidence of accountants and persons experienced in commerce. Such evidence, if credible, should only be rejected if it is contrary to statutory provisions or case law.
 - (e) The question is what was the true cost to the Taxpayer for the 3 lots of shares.
 - (f) **Craddock v. Zevo**², relied on by the Commissioner, is not authority for the proposition that the true cost of the shares issued by the Taxpayer is the par value of such shares.
 - (g) The true cost of the shares issued is their market values ascertained in the context of the 3 transactions.
 - (h) The true value of the shares depends on the evidence called.
 - (i) The true cost is the value of the shares issued by the Taxpayer or the value of the shares acquired.
20. The Executive Director of the Taxpayer gave evidence. We find from his evidence the following facts:-
- (a) The 3 share exchange transactions were negotiated and concluded on the basis of the prices of the respective shares as quoted on the stock exchanges on or about the date of the agreements.
 - (b) The witness was not concerned with the entry of the transactions in the accounts.
 - (c) The entries in the accounts were on the basis of the par value of the shares issued. He could give no reason for this. This was done by the chief accountant who normally took instructions from the Managing Director and another gentleman.
 - (d) The accounts were approved by the Board of Directors.
 - (e) The price of \$5 at which 20 million of the Taxpayer's shares were offered to the public by a prospectus dated 23/8/72 was more than the net asset value per share on that date, but the value based on the completed construction of building works in being and projected was greater than \$5, and may have exceeded \$10 as was the opinion of the witness.
 - (f) There was no material increase in the intrinsic value of the Taxpayer's shares between 23/8/72 and 17/1/73, the date of the Agreement with A Company when the quoted price per share was \$15.70, or 23/2/73, the date of the agreement with B

² 27 T.C. 267.

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Company when the quoted price was \$27.20, or 8/3/73, the date of the agreement with C Company when the quoted price was \$25.

21. Mr. Fong Hup, a partner in Messrs. M. W. Kwan & Co. the auditors of the Taxpayer, gave evidence that he had been personally involved in the audit of the Taxpayer since it was formed. His evidence may be summarised as follows:-

- (a) It was the accountancy practice of the Taxpayer to record in its accounts its shares issued in the 3 share exchange transactions at par value.
- (b) This practice was legal at the time before the 1975 amendment to the Companies Ordinance which required a share premium account to be opened when shares were issued at a price greater than the par value.
- (c) According to the accounts the shares were not shown as issued at a premium.
- (d) When shares are issued at a premium, this should be reflected in the accounts in some way, e.g. before 1975 in a capital reserve account, unless the premium had been used up before the date of the Balance Sheet, in which case it would not have appeared therein.

22. Mr. John Ramsay Marshall, a partner of Messrs. Lowe, Bingham & Matthews and a practising Chartered Accountant with no involvement with the Taxpayer, testified in part as follows:-

- (a) In 1972 the views of practising accountants in Hong Kong varied as to how shares acquired following share exchange transactions should be recorded; there were no common guide lines.
- (b) In his opinion he regarded the acquisitions as having been made at the market values of the Taxpayer's shares on the relevant dates even though the shares issued were entered in the Taxpayer's accounts at their par value of \$2.
- (c) As the shares were acquired by the Taxpayer as trading stock he would have entered their cost at the market values since this would be in accordance with commercial reality.
- (d) The United States practice was unequivocally in favour of recording cost at market value but no firm pronouncement had yet been made by the Institute of Chartered Accountants of England and Wales. A 1971 Exposure Draft issued by the latter body had favoured market value with some qualifications but this draft had not yet been formally adopted as accounting policy.

23. Mr. Francis Richard Zimmern, a sharebroker since 1936, testified as follows:-

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- (a) The only fair basis for the exchange of shares is their market value on an agreed date. The witness gave as an example the exchange between Consolidated Properties & Stores Ltd. and Hutchison International Ltd.
- (b) A discount is sometimes given for cash, never on an exchange.
- (c) Underlying asset values have only been used in mergers.
- (d) An exchange of shares based on the average of stock market prices over an agreed period is inadvisable as there is scope for manipulation.
- (e) The par value of the shares has no relevance in this context.
- (f) The market value is that placed on shares by the public, which is the best judge.

24 Mr. W. F. Bischoff, the managing director of Schroeder & Chartered Ltd., merchant bankers, confirmed Mr. Zimmern's evidence. He also testified that exchanges of shares by companies were common in the latter part of 1972 and in early 1973 and that they were based on the stock market quotations of the shares. He said that the par value was not relevant unless by coincidence it was the same as the market value. The underlying asset value was of no relevance if the shares of both companies were quoted.

25. No evidence was adduced on behalf of the Commissioner.

26. Mr. H. J. Somerville, Senior Crown Counsel, submitted on behalf of the Commissioner that:-

- (a) He agreed with the propositions (a), (b) and (e) put forward on behalf of the Taxpayer and set out in paragraph 19 above.
- (b) The reasons given by the Commissioner set out in paragraph 18 above are correct.
- (c) There is no evidence that the Taxpayer's accounts to 30th June 1973 were not prepared in accordance with commercial and taxation principles.
- (d) The Taxpayer's accounts show a Capital Reserve in respect of the public issue at \$5 per share yet there is no parallel entry for the presently claimed issues at premium, nor any other provision to this effect.
- (e) The Taxpayer's accounts as approved by the Directors and submitted to the Commissioner based on the exchange shares being acquired by the issue of the Taxpayer's shares at par, show adjusted profits of \$20,255,421 and "Provision for taxation \$3,100,000" which latter figure is approximately 15% of the former, the profits tax rate at that time.

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- (f) Here the cost of identified shares acquired for trading stock is shown in the accounts as the par value of certain shares of the Taxpayer; these accounts have been signed and approved by the directors; they have been presented to the shareholders, the cost prices recorded are not in variance with commercial accounting principles; and provision has been made in the accounts for taxation on this basis.
- (g) In these circumstances the cost price of the shares bind the Taxpayer for tax purposes. It is not entitled to assert a different cost price for tax purposes.

27. Mr. Somerville relied on **Craddock v. Zevo Finance Co. Ltd.**², in particular on the following passages:-

- (a) Lord Greene, M. R. at 278:

“It is, I think, true as a general proposition that where a company acquires property for fully paid shares of its own, the price paid by the company is, prima facie, the nominal value of the shares. It is for those who assert the contrary to establish it, ...”.

- (b) Viscount Simon at 287:

“To put the matter in its simplest form, the profit or loss to a trader in dealing with his stock-in-trade is arrived at for Income Tax purposes by comparing what his stock in fact cost with what he in fact realised on resale. It is unsound to substitute alleged market values for what it in fact cost him.”.

- (c) Lord Wright at 289:

“It is admitted, and is found by the Commissioners, that there was a genuine bargain, neither colourable nor fraudulent, as between the two companies concerned, which were separate entities. No question could be raised to impeach the efficacy of the agreement, but the contention here by the Revenue is that the figure of £620,030 should be set aside and some other figure should be substituted so as to affect the accounts of the Respondent Company for the year in question. I have not been able to find any authority which would justify this claim. Apparently the Revenue relies on a comparison between a value of the shares issued as fully paid up, namely £620,030, and what they suggest is the true value of the shares which they put at a figure of something like £360,000. They seem to disregard the obligation which was assumed by the Respondent to discharge the debentures and interest, and simply compare £620,030 with £360,000. The bargain, however, in any case, would have to be looked at as a whole. The case here is an ordinary case of a reconstruction, and there may be many reasons of business which would fairly induce the companies to deal with each other on a particular valuation of the shares transferred. In any case, however, the transaction was one for other than a money

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consideration, and the parties were free to make their own bargain. No authority was cited for the claim of the Revenue in a case like this to go behind the agreed consideration and substitute a different figure.”.

28. In the absence of evidence that the issue prices of the Taxpayer’s shares in the share exchange transaction were entered in its books at their par value by mistake or any explanation therefor, we find that they were so entered as a matter of company policy.

29. The evidence of Mr. Fong Hup was to the effect that the Taxpayer’s accounts were prepared in accordance with an acceptable commercial accounting practice existing prior to October 1975. Furthermore it was also common ground between the parties that the Taxpayer’s accounts were prepared in accordance with commercial accounting practice. It was stated in evidence by Mr. Fong Hup that the accounts were prepared by an unqualified accountant and it seems to some of us surprising that shares exchanged on the basis of market values should have been shown in the accounts at a cost based on par value. However, this practice was apparently approved by the board of directors of the Taxpayer and since both parties are in agreement on this matter we are prepared to accept that for the purposes of this appeal that the accounts were prepared in accordance with commercial accounting principles.

30. We find on the evidence of the Executive Director of the Taxpayer, Messrs. Zimmern and Bischoff that share exchanges were usually negotiated on the basis of stock market values and that this was done in respect of the 3 exchanges of shares the subject of this appeal.

31. We find that the market value of the Taxpayer’s shares on 17/1/73 was \$15.70, on 23/2/73 was \$27.20 and on 8/3/73 it was \$25.00, in accordance with the closing quoted price on the Far East Stock Exchange.

32. Mr. Somerville for the Commissioner contended that the par value of the shares of the Taxpayer should be taken as the cost because this was consistent with the 3 agreements for exchange and the Returns of Allotment. We do not agree. The B Company agreement is silent and therefore neutral on this point and the only reference to the par value is in the description of the shares. In the A Company and the C Company agreements the implication is that the par values would not be the yardstick of price. As to the returns of allotments the Return in respect of the A Company share exchange stated that the consideration was the shares in that company. In the Returns of Allotment for the B Company and the C Company share exchanges, the alleged consideration was not stated and cannot be of assistance.

33. The crucial issue is whether the Taxpayer having prepared its accounts and submitted its Profits Tax Returns which are, it is common ground, in accordance with commercial and tax principles can rely on an amended computation for profits tax based on a different cost price for the 3 lots of shares acquired in exchange and forming part of its trading stock, which amended computation also accords with the principles of commercial accounting.

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34. No authority has been cited to us for the Revenue's proposition that the Taxpayer in the present circumstances is bound for tax purposes by its accounts.

35. Lord Hanworth, M. R. in the **Seaham Harbour Dock Co. v. Crook**³, said:-

“... but as has been said many times in this Court and in the House of Lords, one has to look at the substance of the matter, and the accounts kept by the Company neither inure in their favour or against them if the true effect and substance of the matter grants them relief or imposes a liability.”.

36. Salmon L. J. in **Odeon Associated Theatres v. Jones**⁴, said:-

“... in the present case the commissioners have found on ample evidence an established practice of sound commercial accounting. Sometimes, however, there is no evidence of such a practice; sometimes there is conflicting evidence; and sometimes there is evidence of two parallel but conflicting principles of commercial accounting. In such cases, the courts must do the best they can without evidence, or choose between the conflicting evidence, or decide which is the most appropriate principle of commercial accounting to adopt.”.

37. Somerville, L. J. in **Gold Coast Selection Trust Ltd. v. Humphrey**⁵, said:-

“The method of keeping accounts is often a guide but is never conclusive in Income Tax issues.”.

38. Although these citations from the 3 Lord Justices of Appeal are obiter, in the absence of authority to the contrary we are of the opinion that the Taxpayer is not bound for tax purposes by its accounts. The question still remains whether in the circumstances the Taxpayer can substitute what we have found to be the market value of its shares on the dates of the 3 exchange agreements as the cost price in place of the par value.

39. Mr. Somerville's contention is that in the present case where the Taxpayer has recorded the cost at par value in its accounts and this is supported by other documents (in para. 32 above we have found against the latter contention), and the Taxpayer has acted on this basis, including making tax provisions, then **Craddock v. Zevo**² is authority for the proposition that the par value must be taken as the cost.

40. We are of the opinion that **Craddock v. Zevo**² is not such authority. Lord Greene at 278 only states that the nominal value of the shares is prima facie the price and that is open to rebuttal. Viscount Simon at 287 emphasizes that the cost of the stock is the test. Lord Wright at 289 rejects the substitution of something other than the agreed consideration.

³ 16 T.C. 333 at p. 345.

⁴ (1972) 2 W.L.R. 331 at p. 337.

⁵ 30 T.C. 209 at p. 228.

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These are the passages particularly relied on by Mr. Somerville in support of his contention. The headnote at 268 states the ratio decidendi of the case is that the Crown had failed to establish that the value of the investments was less than the nominal value of the consideration for which the Respondent Company had acquired them. And Atkinson, J. in **Murphy v. Australian Machinery & Investments Co. Ltd.**⁶, said:-

“The *Zevo* case merely laid down this proposition, that an investment company which has bought investments for fully paid shares by transactions which were not illusory is entitled to treat the par value of the shares as the cost to the company of the investments purchased for the purpose of ascertaining the profits made from subsequent resales. The question there was what was in fact the cost to the company of investments purchased by the company for fully paid shares. The case concerned only a company purchasing by the issue of fully paid shares. Quite apart from the fact that the transactions here were obviously illusory as a test of value, the *Zevo* case did not touch the question of the value of the shares in the hands of the person to whom they were issued. That value, as the *Gold Coast* case shows, was the fair intrinsic value or market value of the shares.”

On appeal, Tucker L. J. at 259 expressed his entire agreement with the Judgment of Atkinson, J., and so did Somerville, L. J. at 262 and Cohen, L. J. at 263.

41. We therefore hold that the true cost price of the shares acquired in exchange are the amounts calculated in accordance with the stock market quotations of the Taxpayer's shares on the dates of the respective share exchange agreements, and that the Taxpayer is entitled to rely on such cost price for tax purposes.

42. One member expressed his misgiving about the conduct of the Taxpayer in that:-

- (a) It was open to the Taxpayer to record in its books the cost price of the three lots of shares acquired on the basis of the exchange quotations on the dates of the agreements. These would have been in accordance with commercial and taxation principles;
- (b) The Taxpayer has not done this; instead the cost price of all three lots of shares acquired were entered in its accounts on the basis of the par value of its own shares issued for the exchanges. No evidence was led to explain why this course was chosen or that it was a mistake. No effort, then or subsequently, was made to reflect the true cost of the three lots of shares acquired (i.e. their market value at agreement dates);
- (c) The inference he drew from the course chosen by the Taxpayer is that it sought to derive some benefit therefrom. It could be the item “Quoted shares at cost (Market Value \$51,636,250) ... \$19,752,150”. This item includes the three lots of shares acquired in exchange at a cost equivalent to the par value of the Taxpayer's shares. The item would impress shareholders and the public with the astuteness of the

⁶ 30 T.C. 244 at p. 254.

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Taxpayer's Management. The item would also imply, especially for the layman, that the Taxpayer's assets had been 'understated' and that substantial profit could be expected on future sale of these trading shares. There could be other benefits to the Taxpayer.

However, in consideration of the tax principles and the commercial reality for tax purposes, he came to the conclusion that the appeal should succeed, and that ironically in this case the Taxpayer would be allowed to have the cake and eat it too (i.e. showing its shareholders and the public in its accounts three lots of astute, 'profitable' acquisitions while receiving from the Revenue over \$73 million of tax loss credit on the very same acquisitions).

43. We have considered the probability of fluctuations in the market price if the comparatively large blocks of shares involved in the exchange agreements were actually dealt with in the market. However, we accept the evidence of Messrs. Zimmern and Bischoff that share exchanges were transacted on the stock quotations on an agreed date and also that underlying asset values were never taken into account.

44. The Appeals in respect of all 3 years of assessment are allowed, the assessment for the year of assessment 1972-73 is to be amended to accord with the "Real Cost of Investments per Market Value of shares issued at day of exchange" as claimed by the Taxpayer and set out in paragraph 17 above, the assessments for the following 2 years to be reduced consequentially.