Privy Council Appeal No. 41 of 1985

Southern Pacific Insurance Company (Fiji) Limited *Appellant*

v.

The Commissioner of Inland Revenue *Respondent*

FROM

THE FIJI COURT OF APPEAL

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 24TH FEBRUARY 1986

Present at the Hearing:

LORD TEMPLEMAN
LORD ACKNER
LORD OLIVER OF AYLMERTON
LORD GOFF OF CHIEVELEY
SIR JOHN STEPHENSON

*[Delivered by **Lord Templeman**]*

The appellant company, Southern Pacific Insurance Company (Fiji) Limited, was incorporated in Fiji and since 1st July 1974 has been engaged in the business of underwriting general insurance, including the provision of compulsory third party motor insurance policies. The accounts of the company run from 1st July to 30th June in every year.

Their Lordships agree with the Court of Appeal of Fiji that the company was entitled in calculating its profits for the purposes of the Income Tax Act, Cap. 201, of the Laws of Fiji, to deduct from the aggregate premiums attributable to the risks insured in each year, the aggregate liability of the company for insured accidents and events which occurred during that year. By the end of each year of account, the company will only receive notice of some claims for accidents which have occurred in that year. There will be a large number of accidents which are not reported to the company until after the end of the year of the accident. Their Lordships also agree with the Court of Appeal that the principles enunciated in *Southern Railway of Peru Limited v. Owen* [1957] A.C. 334 are applicable to the Laws of Fiji. In relation to accidents which occur in an

accounting year, but are not reported to the company during that year, so that the company is for the time being ignorant of the obligations which will or may arise as a result of those accidents then, in the words of Lord Radcliffe at page 357:-

> "... their proper treatment in annual statements of profit depends not upon the legal form but upon the trader's answers to two separate questions. The first is -
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> > Have I adequately stated my profits for the year if I do not include some figure in respect of these obligations?
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> The second is -
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> > Do the circumstances of the case, which include the techniques of established accounting practice, make it possible to supply a figure reliable enough for the purpose?"

In its accounts and tax returns for the year ended 30th June 1979 the company deducted $85,000 for claims incurred but not reported, known as IBNR claims, of that year. The Commissioner disallowed the deduction. The Court of Review dismissed an appeal by the company on the grounds that on the evidence 17.94% of claims were unsuccessful because the third party claimants could not prove negligence on the part of the insured driver. The company appealed to the Supreme Court and Madhoji J. allowed the deduction to the extent of 82.06% of $85,000, the company accepting the reduction of 17.94% for unsuccessful claims. The respondent Commissioner of Inland Revenue appealed to the Court of Appeal which disallowed the deduction on the grounds that the company's calculations lacked reliability and did not meet the requirements of the second limb of Lord Radcliffe's formulation in the *Southern Railway of Peru* case at page 357. The Court of Appeal would also have disallowed the deduction on the alternative ground that the sum of $85,000 claimed as a deduction constituted income carried to a reserve fund which was not deductible by virtue of the express provisions of section 19(g) of the Income Tax Act. The company appeals with leave to Her Majesty in Council.

The only evidence was given before the Court of Review on behalf of the company by a chartered accountant of the firm of Price Waterhouse, the auditors of the company, and by the company's insurance general manager. The evidence was that in 1974, in the absence of relevant experience, IBNR provision could not be accurately assessed. But by 30th June 1979, examination of claims made since 1974 indicated that about 50% of claims were unreported at the end of the relevant year of accident. Experience of claims paid indicated that IBNR claims over a

four-year period amounted to 45% of known claims outstanding. From these figures and from detailed calculation made in the light of claims experienced during the four-year period, the witnesses deposed that by 30th June 1979 an IBNR provision was necessary and that past experience provided a satisfactory basis for the calculation of the required provision. The amount of $85,000 claimed as a deduction was supported by written calculations and analyses which were produced by the witnesses and were the subject of examination and cross-examination.

The criticisms of the Court of Appeal were three-fold. First they commented on the initial failure of the company to allow 17.94% for unsuccessful claims. But this failure did not cast any doubt on the calculation of the original claim of $85,000 based on the experience of the company with regard to claims since it began business. Secondly, the Court of Appeal suspected that provision for an IBNR claim in one year would be duplicated by providing for an outstanding claim once the IBNR claim was reported. This suspicion is ill-founded. A claim, when reported, disappears from the next valuation of IBNR and becomes part of the next valuation of outstanding claims unless it has been settled in the meantime. IBNR and outstanding claims are adjusted each year by reference to the provision made at the beginning of the year. There is thus no double provision. Thirdly, the Court of Appeal considered that the IBNR claim should have been discounted because the claims would not fall to be paid until some time in the future. But, as the company's cogent case to the Board points out, discounting was unnecessary and undesirable. Experience showed that the bulk of IBNR claims are notified in the following twelve months. The amounts of the claims are liable to be inflated until payment by general increases in the assessments of damages and by interest. It was never suggested to the witnesses and there is no evidence that discounting is necessary to prevent over-provision for IBNR.

The Court of Review and the Supreme Court, the sole judges of fact, accepted the evidence of the company's witnesses and the reliability of the company's calculations and forecasts. They accepted IBNR of $85,000 for the year ended 30th June 1979 subject to a deduction of 17.94% to allow for claims which would prove to be unsuccessful. An appeal to the Court of Appeal and to the Board only lies on a question of law so that the findings of the Court of Review and the Supreme Court cannot be disturbed unless they were findings which no reasonable tribunal, properly instructed as to the law, could reach; see *Edwards v. Bairstow* [1956] A.C. 14. Their Lordships have carefully considered the criticisms

made by the Court of Appeal and the further criticisms made by counsel for the respondent of the evidence of the witnesses and the calculations of the company. Those criticisms are not sufficiently cogent to warrant rejection of the evidence or of the reliance by the Court of Review and the Supreme Court on that evidence.

The second ground relied upon by the Court of Appeal is based on section 19 of the Income Tax Act. That Act provides for income tax to be paid on the total income of a taxpayer and by section 19:-

> "In determining total income, no deductions shall be allowed in respect of -
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> ...
>
> (g) income carried to any reserve fund or capitalised in any way;"

In the *Southern Railway of Peru* case where the company deducted from its annual profits lump sums payable on the future retirement, death or termination of service of an employee, the House of Lords approved in principle of the deductions and Lord Radcliffe at page 358 said:-

> "... annual profits properly determined are not to be treated as reduced by the circumstance that some part of them may be prudently reserved from distribution ... to take care of an apprehended loss from future trading, [but] ... the accountants who have given evidence would say ... that they were not advocating the making of a reserve, but seeking to evaluate a current cost of working."

In the present case, the amount of the liability of the company for accidents which occurred but were not reported in a particular year, is part of the expense of the company in carrying on its insurance business during that year and must be deducted in arriving at the total income of the company for that year. Section 19(g) only provides that profits once calculated cannot be carried to reserve and then further deducted. Section 19(g) forbids a company to appropriate or capitalise profit but does not affect the calculation of profit.

Their Lordships will therefore humbly advise Her Majesty that the appeal should be allowed, that the order of Madhoji J. should be restored and that the respondent should pay the costs of the appellant before the Court of Appeal. The appellant is also entitled to its costs before the Board.