

Friday, February 8.

FIRST DIVISION.

[Sheriff of Argyllshire.

M'LAREN v. HILL.

Bankruptcy—Catholic Security—Assignment of Security by Prior to Postponed Creditor—Titles to Land Act 1868 (31 and 32 Vict. cap. 101), sec. 123.

A heritable subject was burdened with a first bond, and also with a second bond. The first bondholder executed a pouncing of the ground, and thereafter the debtor became bankrupt. The first bondholder by his pouncing of the ground obtained a preference to the extent of one year's unpaid interest. He sold the subjects under his bond, and took payment of his debt, both principal and all unpaid interest, out of the price. The second bondholder then obtained from him an assignation of the preference he had obtained by pouncing the ground, and claimed for that sum in the sequestration. *Held* that the first bondholder having been bound in equity to communicate to the second the preference he had obtained to the second, the claim of the latter in the sequestration was good.

James Nicol, solicitor, Oban, was proprietor of certain heritable subjects there called Craigievar. In May 1883 Nicol borrowed on the security of these subjects from Thomas Syme, Edinburgh, £2500, and in November 1884 he borrowed, on a second bond on the same security, £500 from Francis Hill, Ardrishaig.

In 1887 Nicol's affairs became embarrassed, and on 10th June Syme executed a pouncing of the ground, and on 10th June obtained decree thereunder. On 21st June Nicol was sequestrated, and John F. M'Laren, solicitor, Oban, was appointed trustee.

On 18th October Hill served a petition of pouncing the ground upon the said trustee, but this action was not persevered in. The amount of moveables attached by Syme's pouncing of the ground was £122, 16s. 1d., being the amount of one year's unpaid interest on the bond.

Section 123 of the Titles to Land Act 1868 (31 and 32 Vict. c. 101) provides—"Upon a sale being carried through in terms of this Act, and upon consignation of the surplus of the price, if any be, it, as aforesaid" [sec. 122], "the disposition by the creditor to the purchaser, shall have the effect of completely disencumbering the lands and others sold of all securities and diligences posterior to the security of such creditor, as well as of the security and diligence of such creditor himself."

In October 1887 Syme sold the said heritable subjects for £2900. Out of the sum of £2900 obtained for the subjects Syme paid himself both the amount of his debt and also all the interest due to him.

Thereafter on 26th January 1888, at the request of Hill, as second bondholder, Syme assigned to him the preference to the extent of £122, which he had acquired by his pouncing of the ground. The assignation was on 13th February intimated to the trustee.

Hill then lodged a claim in the sequestration

for the sum of £122, 16s. 1d., as the amount carried by the assignation, but this claim was rejected by the trustee.

Hill appealed against this deliverance, and averred that the effect of Syme's pouncing of the ground was to give him (Syme) a preference over the moveables on the ground for one and a-half years' interest; that as a postponed creditor he was prejudiced by the first bondholder paying himself interest as well as capital out of the price of the heritable subjects, and that he only consented to this being done on his obtaining the assignation to the preference created in Syme's favour by his pouncing of the ground.

The trustee averred that when the first bondholder sold the heritable subjects under the powers in his bond, and secured payment of his principal and interest, his decree of pouncing of the ground became inoperative, and was extinguished at common law and under the provisions of section 123 of the Titles to Land Consolidation (Scotland) Act 1868, quoted *supra*.

Hill pleaded that he was entitled to decree as he was in right of the preference acquired by the first bondholder.

The trustee pleaded, *inter alia*—" (1) The assignation founded on is of no effect, in respect, first, that the decree assigned was previously extinguished, and second, that no value was given for the same. (2) The sum claimed having already been paid out of the bankrupt estate, the present is a claim for a double ranking. (3) After a sale of the heritable subjects, the first bondholder could not put the said decree in force, and his assignee is in no better position than his cedent."

On 31st October 1888 the Sheriff-Substitute (MACLACHLAN) pronounced the following interlocutor:—" . . . Finds that the holder of the first bond and disposition in security executed a pouncing of the ground, whereby he secured a preference over the moveables on the ground to the extent of £122, 16s. 1d. sterling, being one year's interest, less tax; that the said heritable subjects were sold in October 1887 by the first bondholder at a price more than sufficient to pay his debt and interest, and thereafter, by assignation dated 28th January and intimated 13th February 1888, he assigned to the appellant, as the postponed bondholder, the security created by the said pouncing of the ground: Finds in law that the said assignation was valid and effectual to convey said security to the appellant: Therefore recalls the trustee's deliverance, and ordains the respondent to rank the appellant as a creditor on the sequestrated estates of the said James Nicol in terms of his claim, with the interest that has accrued on the dividend set apart for the appellant, &c.

"*Note*.—In this case the trustee seems to be under a misapprehension as to the meaning of section 123 of the Titles to Land Consolidation (Scotland) Act 1868. He holds that upon a sale being carried through in terms of that Act the security and diligence of the selling creditor are extinguished. But this is only in regard to the subjects actually sold, and in a question with the purchaser. The provision in the section is that the disposition to the purchaser shall have the effect of disencumbering the lands and others sold—that is to say, the purchaser is entitled to receive the lands and others freed and disen-

cumbered of the burdens therein referred to, but the creditor is not freed of the obligation contained in the previous section (122) of holding count and reckoning with the debtor and the postponed creditor. When the sale to which this action refers took place the selling creditor's debt consisted of the principal sum of £2500 and £122, 16s. 1d., being one year's interest, less tax, and his security consisted of the bond, along with the preference created by his pointing of the ground. In the circumstances it was unnecessary for him to realise the security created by his pointing of the ground, seeing that his principal debt and interest were paid out of the proceeds of the sale of the heritable subjects. But there still remained the obligation in section 122 of holding count and reckoning with the postponed creditor, and this obligation he fulfils by paying over the balance of the price, and assigning his diligence of pointing of the ground, being the unrealised portion of his security.

"The appellants, by withdrawing the pointing of the ground executed by him, gave up the security thereby created over the moveables, and his security was thus confined to the heritable subjects, and I hold that the first bondholder, seeing that his security extended over the moveables as well as over the heritable subjects, was not entitled to defeat the second bondholder's claims by selling only that portion of the property which formed the latter's sole security, and paying himself in full out of the proceeds, leaving the other portion untouched."

The pursuer appealed to the Court of Session, and argued—The Sheriff-Substitute had taken an entirely wrong view of the provisions of the Titles to Land Act, and the language of section 123 had no application to an assignation of a decree of pointing of the ground. This decree created no preference in Syme. It merely put a *navis* on the moveables, and to have had any practical effect it would have been necessary that it be followed out. This was not a case of a catholic creditor, for here there was only one subject of security, as the sale of the lands of the first bondholder disencumbered them from all diligences. If Hill was entitled to any preference whatever it ought to be limited to £22, the restricted amount allowed by the Bankruptcy Act on his own bond, and not to the £122, 16s. 1d. as assigned by the first bondholder. This assignation was quite invalid, and no effect could be given to it, for at the date of assignation the debt had been paid, and there was no grounds upon which it should be paid twice—*Urquhart v. M'Leod's Trustees*, June 16, 1883, 10 R. 991; *Boswell v. Ayr Banking Company*, January 15, 1841, 3 D. 352.

Argued for Hill—This was a case of catholic and secondary creditors, and the first bondholder, who held a security over both subjects, was not entitled capriciously to injure the second bondholder's interests, but was bound to assign to him any right which he had (after he had paid himself) over the subjects over which he alone held a security, *i.e.*, over the moveables. This was a case of an assignation of a diligence, and the rights of parties must be settled as at the date of the sequestration. On catholic and postponed creditors, see 2 Bell's Comm. 418; *Littlejohn v. Black*, December 13, 1855, 18 D. 207; *Goldie*

v. Bank of Scotland, February 27, 1834, 12 S. 498. The interests of the postponed bondholder had been seriously prejudiced by what the first bondholder had done, and his security had been diminished, and the first bondholder was legally bound to assign to the second bondholder any preference that he had over the moveables. Even though the moveables had been sold, the second bondholder was not too late to obtain a ranking for the sum assigned to him by the first bondholder—*Lyons v. Anderson*, October 21, 1880, 8 R. 24; *Athole Hydropathic Company v. The Scottish Provincial Assurance Company*, March 19, 1886, 13 R. 818.

At advising—

LORD PRESIDENT—The present question arises in course of the sequestration of a certain James Nicol, a solicitor in Oban, whose estates were sequestrated on 21st June 1887. There were two heritable securities held over this estate, the first created in 1833 for £2500 by a Mr Syme, and a second by Mr Hill, the respondent in this appeal, for £500. Hill's position was therefore that of a second bondholder, while Syme was a first bondholder.

Both creditors executed pointings of the ground. That by Syme was executed on 10th June 1887, while the other by Hill was executed on the 18th of October of the same year. These pointings of the ground were of course restricted by the provisions of sec. 118 of the Bankruptcy Act, which denies all effect to pointings of the ground after sequestration, or within sixty days of bankruptcy, except to a limited extent, namely, to interest on the debt for the current half-yearly term, and for the arrears of interest for one year before the commencement of such term. The extent of the first bondholder's interest in the moveables as thus restricted was £122, 16s. 1d.

The first bondholder availed himself of his powers under the bond, and sold the estate in October 1887 for £2900, and out of this sum he not only paid himself in full with interest, but there was in addition a surplus left over for the second bondholder, which surplus of course the first bondholder is liable to account for to the second bondholder. The first bondholder proposes to hand over this sum to the second bondholder, who objects to what the first bondholder has done, because he has taken full payment of his bond and interest from the price of the subjects sold, whereas he avers that he ought to have taken the interest of his bond out of the moveables which he had pointed. The second bondholder maintains that as the first bondholder held two securities he ought to have divided the burden of his bond and the interest between these two securities. That proceeds just upon this principle, that the prior bondholder held a catholic security over the heritable and moveable estate, and was therefore bound so to realise the securities as to leave as large a surplus as possible for the second bondholder. In answer to this Syme assigned to Hill the £122, 16s. 1d., the security created by the said pointing of the ground, and Hill now claims to be ranked preferably for that sum in the sequestration on the principle of the equity applicable to catholic securities, and the question comes to be, whether that equity is admissible in the pre-

sent case. This equity is well established in our law, but I may just advert to what Mr Bell says on this subject, carrying out the doctrine as he finds it laid down by Lord Kames in his remarkable work (2 Bell's Comm. 411)—“Where two estates of the same debtors are covered by a security for the debt, and there is no third party interested in either of the estates, the operation of the principle is obscured by the identity of interest in the proprietor, the creditor may of course take his payment from either estate, and there can be no room for assignation, the debt being to all purposes extinguished. But if a separation of interests in the two estates takes place (e.g., if the debtor dies, and is succeeded by two heirs in different lines of succession) the same rule must of course be applied as if the estates had belonged originally to two several debtors. They must pay the debt rateably in proportion to the value of the estates, and if the proprietor of one pay the whole, he is entitled to an assignation that he may recover the share belonging to the other,” and then follows a passage which is specially applicable—“Where there are secondary creditors on the two estates the right of the catholic creditor to demand his debt must suffer the same qualification as if the estate belonged to several proprietors. Thus, if A have an heritable bond over two estates belonging to B, and C have an heritable security over the one estate, and D an heritable security over the other, A cannot capriciously prefer the one to the other by claiming his debt from one of the estates, leaving the other free, but must in equity assign his security.”

Now, the question comes to be, Is that doctrine applicable in the present case? The peculiarity is that we are dealing here with heritage and moveables as separate subjects of security. Both creditors have a separate security over both estates—that is to say, each creditor has a security over the real estate, and to a limited extent over the moveables also, and the moveable estate is sufficient to pay these limited claims, and that is the peculiarity of the present case which distinguishes it from any of the previous cases.

There can of course be no doubt that if the first bondholder had taken his £122 out of his debtor's moveable estate he would have left just this amount more of the heritage available for the second bondholder. But he has elected to take all of his debt and interest out of the heritage, and has therefore diminished to this extent the heritable security. It is just in circumstances such as these that the equity applies, because when the first bondholder has made good his security in such a way as to damage the second bondholder, then he is bound to grant to him an assignation of his security so that the second bondholder may make what he can out of it. The first bondholder has the alternative of apportioning his debt between the two securities or of going entirely against one of these securities, and of assigning his right to the other security to the second bondholder.

But it is urged that to apply this doctrine here would be to benefit the second bondholder at the expense of the general body of creditors. But that is just the effect of the application of this doctrine of catholic security in any case, for whatever confers upon a second bondholder more

than he would otherwise have got must have the effect of damaging more or less the interests of the other unsecured creditors. I see no reason here for the exclusion of this equity, and I therefore think that the Sheriff-Substitute has acted quite rightly in what he has done.

LORD MURE—I quite agree with what your Lordship has said in this case, and think that the Sheriff-Substitute has done rightly in the course which he has adopted.

Your Lordship, in the passages read from Mr Bell's Commentaries, has laid down the principle upon which this case must be decided, and these principles were given effect to by the Court in the case of *Littlejohn*, which was referred to in the course of the discussion.

There can be no doubt that the second bondholder was prejudiced by the actings of the first bondholder, who, however, was in no way to blame in what he did. He has assigned his interest in the moveables to the second bondholder, who is undoubtedly preferable to the general body of creditors, and he having done so, the Sheriff has merely given effect to that assignation.

LORD SHAND—In this case each of the creditors had a bond and disposition in security from the bankrupt over the heritable estate, and also a security over the moveables to the extent of one year's interest. The first bondholder exercised his diligence over the moveables, and then fell back on the heritage, but he has assigned his interest in the moveables to the second bondholder, who now seeks to obtain the benefit of that assignation. I think that the principle laid down in the passages in Bell referred to by your Lordship fully sanction what has been done here, and that this principle was given effect to in the case of *Littlejohn*, which I consider to be *a fortiori* of the present case. The second bondholder must not be prejudiced by the actings of the first bondholder, and in giving effect to this assignation the Sheriff-Substitute has, I think, acted rightly.

LORD ADAM—I am clear that if the second bondholder Hill had held no security over the debtor's moveable estate then this would have been an ordinary case of catholic and postponed creditor, and in such a case the equity which has been referred to would have directly applied. Does it then make any difference that Hill has a security over the moveables? I do not think it does. In the ordinary case where there are prior and postponed creditors it little matters out of which security the prior creditor takes payment of his debt, because he leaves so much more to the postponed creditor from the untouched security. But here each creditor has a limited right to both securities, and neither creditor can exhaust the moveables. That, to my mind, is just a case for the application of the equity. The prior bondholder was bound to realise his security in such a way as to be as little injurious as possible to the interests of the second bondholder. In these circumstances Syme ought to have paid himself the £122 out of the moveables, and if he had done so the heritable security would have been so much the larger to pay Hill's debts. But Syme did not do so; he paid himself capital and interest out of the heritage, and has assigned his security over the moveables to the

second bondholder Hill, who is entitled, I think, to have effect given to this assignation.

I think therefore that the Sheriff-Substitute has acted rightly.

The Court refused the appeal.

Counsel for the Appellant—Guthrie—Craigie.
Agents—Welsh & Forbes, S.S.C.

Counsel for the Respondent—Strachan—Patten.
Agents—M'Neill & Sime, W.S.

Friday, February 8.

FIRST DIVISION.

[Exchequer Cause.

THE SCOTTISH UNION AND NATIONAL INSURANCE COMPANY AND OTHERS, AND THE NORTHERN ASSURANCE COMPANY AND OTHERS v. THE COMMISSIONERS OF INLAND REVENUE.

Revenue—Income-Tax—Property and Income-Tax Act 1842 (Act 5 and 6 Vict. cap. 35), Schedule D, First Case—Insurance Company, Fire and Life—Profits or Gains.

The Income-Tax Act 1842, Schedule D, Case 1, Rule 1, provides—"The duty to be charged in respect of" (trades, &c., not embraced in any other schedule) "shall be computed on a sum not less than the full amount of the balance of the profits or gains of such trade . . . upon a fair and just average of 3 years ending on such day of the year immediately preceding the year of assessment on which the accounts of the said trade . . . shall have been usually made up."

A company carried on the business of fire and life insurance, including the sale of annuities, and from time to time realised its investments when an opportunity offered of its doing so at a profit. *Held*, in assessing to income-tax, (1) that the nett profits and gains from the two branches of the business were to be massed as one undivided income, assessable according to the rules applicable to Case I. Schedule D; (2) that in estimating the profits and gains of the company, interest on investments which had not suffered deduction of income-tax at its source must be taken into account, as also fire insurance premiums for the year of assessment, or an average of 3 years (less losses by fire in that period, and ordinary expenses), and gains made on investments realised during either of these periods; (3) that the profits and gains of the company on its life business could only be ascertained by actuarial calculation, proceeding upon the result of the statutory quinquennial investigation, or of the usual periodical investigation in companies established before the statute, or of the triennial investigation prescribed by Schedule D of the Income-Tax Acts

The Income-Tax Act 1842 (5 and 6 Vict. cap. 35), sec. 100, Schedule D, Case 1, provides—"Duties to be charged in respect of any trade, manufacture, adventure, or concern in the nature of trade not contained in any other schedule of this Act." Rule First provides—"The duty to be charged in respect thereof shall be computed on a sum not less than the full amount of the balance of the profits or gains of such trade . . . upon a fair and just average of three years ending on such day of the year immediately preceding the year of assessment on which the accounts of the said trade . . . shall have been usually made up." . . .

At a meeting of the Commissioners of Income-Tax for the County of Midlothian for hearing and determining appeals, held at Edinburgh on 27th October 1886, the general manager of the Scottish Union and National Insurance Company appealed against an assessment made on the company under Schedule D of the Income-Tax Acts for the year 1885-86. The assessment was appealed against by the company, *inter alia*, on the ground of the decisions of the English Courts on the appeal case of *Last v. The London Assurance Corporation*, 14th July 1885, L.R., H. of L. App., vol. x. p. 438, it being contended that according to such decisions, after taking into account the income-tax paid by way of deduction from interests and dividends on the company's invested funds, there remained no balance of profit for direct assessment.

The following were the facts:—1. The appellants were incorporated under a special Act of Parliament, 41 Vict. cap. 53, and they carried on the business of fire and life insurance, including the sale of annuities and other ordinary branches of the said businesses within the limits defined by the said special Act. The results of their business in all departments, so far as their shareholders were concerned, were thrown together into one account, called the profit and loss account, and dividends to the shareholders were declared out of the balance of profit shown upon this account, and not out of profits made in any particular department. 2. The profits of the appellants' fire insurance business were ascertained from year to year. In respect of the premiums in hand at the end of each year, risks were still running under existing policies, which risks might be taken as equivalent on an average to one-third of the premiums received during the preceding year. It had been the custom for many years to reckon the profits of fire insurance business with reference to income-tax upon a seven years' average, but the appellants were satisfied to accept the ruling of the Commissioners, and reckon these profits upon a three years' average. 3. The whole interest, dividends, rents, and other revenue from invested funds received by the appellants were divided into two portions, one of which, being the proportion of the whole which was earned from the investment of the paid-up capital and reserves belonging to the shareholders, passed to the credit of their profit and loss account, and formed a portion of their yearly profits. The remainder of the interest, dividends, and other revenue from invested funds was earned from the investment of the accumulated life and annuity premiums, and went to provide for the company's obligations under its life assurance and annuity policies. 4.