

VOL VI.—PART II.

No. 328.—IN THE HIGH COURT OF JUSTICE (KING'S BENCH DIVISION).—3rd and 4th March, 1910.

COURT OF APPEAL.—10th April, 1911.

HOUSE OF LORDS.—23rd January and 7th March, 1912.

THE SUN INSURANCE OFFICE *v.* CLARK (Surveyor of Taxes).⁽¹⁾

Income Tax (Schedule D).—Profits. A Company carrying on the business of fire insurance, had made a practice of carrying forward annually, in its published accounts, as a reserve, 40 per cent. of the yearly premium receipts representing estimated losses on unexpired risks, and had claimed to be assessed on this basis. It was found as a fact by the Commissioners that 40 per cent. was a reasonable and proper allowance, and the Company's claim was admitted. The Crown contended that the Company was not legally entitled to the allowance.

Held, that The General Accident Fire and Life Assurance Corporation *v.* McGowan⁽²⁾ notwithstanding, there is no rule of law as to the admissibility of an allowance for unexpired risks in estimating profits, but the question is one to be decided by reference to the facts in each case; and that on the facts found in this case the allowance claimed was a proper allowance to be made.

CASE stated under the Statute 43 and 44 Vic. Cap. 19, Sec. 59 by the Commissioners for the General Purposes of the Income Tax Acts for the City of London for the opinion of the King's Bench Division of the High Court of Justice.

1. At a meeting of the said Commissioners held at the Guildhall Buildings in the said City on the 26th day of April, 1906, the Sun Insurance Office appealed against an assessment of £144,452 for the year ending the 5th April, 1906, made upon them under Schedule D to the Act 16 and 17 Vic. cap. 34, under the following circumstances:—

2. The Sun Insurance Office carries on the business of Fire Insurance with a Registered and Head Office of the Company in London, and branches and agencies all over the world. Its annual premium income during the three years under average in relation to the assessment appealed against was as follows:—

				£	s.	d.
1902	...	...	...	1,208,661	10	5
1903	...	...	...	1,222,666	7	10
1904	...	...	...	1,306,180	1	4

(1) Reported at [1912] A.C. 443.

(2) The headnote in this case, at 5 T.C. 308, is therefore incorrect.

Apart from other Reserves, as to which no question arose, amounting at December, 1904, to £1,632,134 12s. 11d. this Office had since 1888 been in the habit of carrying forward annually, in its published accounts at 31st December, 40 per cent. of its yearly premium receipts as a reserve, or allowance, in order to bring about the correct incidence as between year and year of the premium income which has to answer the accidental incidence of fire losses, and on the balance of which, over or under the losses and charges for the year, the profit or loss attaching to their business depends.

Prints of the published reports, accounts and balance sheets of the Company for the three years ending respectively the 31st December, 1902, 1903, and 1904, are annexed hereto and made part of this Case.⁽¹⁾

3. The provision thus made of 40 per cent. on the premium income for the annual outstanding liability of the Office in respect of unexpired risks amounted at December, 1901, to £466,138 13s. and rose, during the triennium on which the assessment appealed against is based, to £522,472 0s. 6d. The increase in this allowance during the triennium amounted to £56,334, and, consequently, affected the return for the tax year by one-third or £18,778. This sum was the only matter in dispute on the appeal, the assessment of the Office being otherwise agreed at £144,452, which the then Appellants claimed to reduce by £18,778, to £125,674.

4. The question in dispute is set out in the following statement showing the composition of the amount at issue in relation to the Reserve made by the Sun Fire Insurance Office for the unexpired risks, being 40 per cent. of premium income:—

	£	£	
1902, closing amount	483,464		
opening amount	466,138		
			17,326
1903, closing amount	489,066		
opening amount	483,464		
			5,602
1904, closing amount	522,472		
opening amount	489,066		
			33,406
			3)56,334
			£18,778

The Appellants contended *inter alia*:—

(a) That, in view of the fact that all insurance premiums are prepaid and that at any given date when a balance sheet is drawn up payments have in fact already been received for risks which will remain to be run off after the date of the balance

⁽¹⁾ Not included in the present print.

sheet, to treat all premiums receivable up to the date thereof as income, without deduction of the proportion prepaid and unexpired, is unjustifiable and commercially unsound and is not obligatory under the Income Tax Acts, and in any case ought not to be forced on an Office which, as between itself and its shareholders, takes steps by means of a proper reserve for unexpired and unearned premiums to throw the real premium income into each year to answer its actual losses.

(b) That before the Directors can properly include in a profit and loss account as at 31st December, 1904, all premiums receivable up to that date as income, they ought, if not entitled to carry forward such a reserve as they in fact make in their accounts, to provide in some other way for the unexpired risks, and that in effect each successive year takes over from, and indemnified its predecessor against, its unexpired risks, and the 40 per cent. allowance made for the purpose is equally chargeable against the gross premium income as though it were a re-insurance premium paid out of pocket for the indemnity.

(c) That the premiums are earned not by being got in but by the Office remaining on the risk for the agreed term of the policy, and that the Company is justified in throwing into each year the risk bearing premium which belongs to it.

(d) That 40 per cent. is, in fact, and is recognised by the best informed opinion of the insurance world as being, the irreducible minimum rate for such an allowance and that the estimate of 40 per cent. for the year of assessment had itself proved greatly insufficient by reason of the losses in respect of the San Francisco fire calamity and similarly in other years.

6. The Surveyor on behalf of the Crown contended *inter alia* :—

(a) That no allowance be made for unearned premiums and relied on the case of the *Imperial Fire Insurance Co. v. Wilson*, 35 L.T. 271 (1 T.C. 71), *The Scottish Union and National Insurance Co. v. Smiles* and *Northern Assurance Co. v. Russell* (2 T.C. 551).

(b) The Surveyor admitted that if the Commissioners decided that the Company were legally entitled to such allowance as was claimed, he was not, for this specific appeal, in a position to contest that 40 per cent. was an accurate estimated reserve.

7. The Commissioners having heard the evidence of Mr. B. W. Hardcastle of the firm of Spain Bros. & Co., Chartered Accountants, Auditors to the Fire Office, and of Mr. G. E. Mead, Assistant Secretary, and having considered the above named Cases, were of opinion :—

- (1) That the Company is entitled to carry a percentage of fire premiums received in one year forward in reserve in respect unearned premiums which do not form part of the profits of the year.
- (2) They found as a fact that in the case of the Sun Fire Insurance Office, 40 per cent. was a reasonable and proper allowance. The Commissioners then directed that the assessment should be reduced accordingly.

8. The Surveyor of Taxes thereupon expressed his dissatisfaction with the decision of the Commissioners as being erroneous in point of law and duly required them to state and sign a case for the opinion of the High Court of Justice which we have stated and do sign accordingly.

H. COSMO BONSOR,
HOWARD MORLEY,
S. S. GLADSTONE,
W. D. POWLES,
GREVILLE H. PALMER,
W. P. TRELOAR,
SYDNEY E. BATES,

} Commissioners of Taxes
for City of London.

THOMAS HEWITT,

Counsel and Clerk to the Commissioners,
The Guildhall Buildings, London, E.C.

The case was argued before the Court on the 3rd and 4th March, 1910, the Attorney-General (Sir W. Robson, K.C., M.P.), and Mr. W. Finlay appearing as Counsel for the Appellant and Mr. Danckwerts, K.C., and Mr. Bremner for the Respondents. Judgment was given on the second day in favour of the Respondents, with costs.

JUDGMENT.

Bray, J.—I feel a good deal of difficulty in deciding this case because of the cases that have been already decided, particularly the case of *The General Accident Fire and Life Assurance Corporation v. McGowan*,⁽¹⁾ which has gone up to the House of Lords.

If I for a moment discard all the cases I should not have any hesitation in saying—and Mr. Finlay has fairly conceded it—that the proper way to arrive at the profits of the year is to deduct at the end of the year some sum which will fairly and properly represent the liability owing to the unexpired risks. You may put it in this way, that the whole of the premiums have not been earned and they are not profits; or you may prove that there is a contractual liability to pay in certain events certain persons the losses that they may have sustained by fires; just in the same way as there is a liability, when you have entered into any contract to do something, to do that thing. If you have agreed to pay five months hence a sum of £1,000, that is a liability which you must take into account when you are estimating the profits of the year. You have received your goods and you must set against them the price that you are going to pay; and the fact that that price has not been paid during the year does not prevent it being deducted. You must deduct the value of the liability to pay that price whenever it occurs. Therefore I doubt not, except for a few observations of Chief Baron Kelly in the case of the *Imperial Fire Assurance Company*

(1) 5 T.C., 308.

v. *Wilson*⁽¹⁾ that the real and proper way to arrive at the balance is by making a deduction at the end of the year for the value of the liability in respect of the unexpired risks, and of course at the beginning of the year to bring a like sum into account on the other side of the account.

Then starting with that, what has to be done? It seems to me it is not a question of law at all. It is a question of fact to be determined by evidence. I think that can hardly be disputed. But it is said that there has been a practice adopted and a rule adopted many years ago and it is too late to interfere with that rule. Now if I could find that the House of Lords by a majority had decided that I should be concluded. It is quite true that Lord Macnaghten and Lord Collins have said that, but Lord Loreburn has not, and I have nothing to show that the other noble Lords agreed with Lord Macnaghten and Lord Collins; and therefore it comes to this that what Lord Macnaghten and Lord Collins say are at most *dicta*. I do not feel pressed with that difficulty about the rule because if it is not the right rule I do not see any difficulty, if you can get at the right rule, in substituting that rule for it; but in truth the rule is not a rule universally applicable. You must look at the facts in each particular case.

Now, as I say, having arrived at what would be the proper way of doing it I must first look and see what the facts stated are. Now it is necessary, and quite necessary in my opinion, that the Respondents, the Sun Fire Insurance Office, should have proved before the Commissioners that a certain sum, namely the sum which they claimed to deduct, is the proper sum to be deducted and truly represents the liability in respect of these unexpired risks. Is that to be found? I look at paragraph 7 of the Case. There are the arguments which precede it, and I pass those by for the moment. Paragraph 7 states "The Commissioners, having heard the evidence of Mr. B. W. Hardcastle of the firm of Spain Brothers & Co., Chartered Accountants, Auditors to the Fire Office, and of Mr. G. E. Mead, Assistant Secretary, and having considered the above named cases, were of opinion:—(1) That the Company is entitled to carry a percentage of fire premiums received in one year forward in reserve in respect of unearned premiums which do not form part of the profits of the year." I do not know that I should put it quite in that way, but in effect it is the same thing as saying that there should be a deduction in respect of the liability for unexpired risks; but I do not think it much matters which way you put it. I do not think there is anything wrong in that as a matter of law. They find it as a fact. They found as a fact that "in the case of the Sun Fire Insurance Office"—that is in this case, not as a general rule, but in this case—"40 per cent. was a reasonable and proper allowance." I am told as a finding that 40 per cent. represents the liability in respect of the unexpired risks. Of course it must vary from year to year, necessarily, and it necessarily has to be an estimate, and it may prove quite fallacious in the end, just as it may in life assurance or any other assurance, because the life may die within two years

(1) 1 T.C., 71.

instead of as an actuary would say it ought to die, in 20 years. So a fire may take place during this next year instead of taking place as it ought to have done 20 or 40 years hence. The Commissioners, then, were of opinion that the assessment should be reduced. I think the Commissioners, who, when one looks at their names, are eminent business men, have come to the conclusion that as a matter of fact 40 per cent. does represent the liability in respect of the unexpired risks,

Now I go back to the cases to see whether there is anything in the cases which prevents me taking that fact and acting upon it. In the first case—the *Imperial Fire Insurance Company v. Wilson*⁽¹⁾—it is quite clear that upon the facts of that case the Court of Exchequer were quite right, because it was for the Insurance Company to prove what the proper deduction was and they failed to prove it. That is the short ground upon which it seems to me that they decided. It is quite true they did not put it entirely upon that ground, or certainly all the learned Barons did not put it upon that ground, but two of them did say, I think, that if you could arrive at a proper sum in the way suggested that was the proper way to do it; but they found on the facts that it had not been proved that that was the proper sum and therefore they took a more rough and ready rule, which was the rule which had in fact been adopted by the Company itself. That deals with that case.

The next case—*The Scottish Union and National Insurance Company v. Smiles*⁽²⁾ and *Northern Assurance Company v. Russell*⁽²⁾—in 1889 is a more difficult one to deal with, undoubtedly, because there the Lord President said that this was a proper direction to give. “Seeing that fire insurance policies “are contracts for one year only, premiums received for the year “of assessment, or on an average of three years, deducting “losses by fire during the same period and ordinary expenses, “may be fairly taken as profits and gains of the Company without taking into account or making any allowance for the “balance of annual risks unexpired at the end of the financial “year of the Company.” He says:—“It may be fairly taken.” That was the conclusion he arrived at from the facts stated in that case and the facts stated in that case were undoubtedly different from the facts stated in this case. There was no such finding of fact as is found here. There had been no carrying on of the business by the Insurance Company upon any accounts made out in this fashion. It was a theoretical method which was being put forward, rather than one which had been adopted in practice. Therefore in such a case as that, assuming the facts to be as they are stated, it may have been a perfectly proper direction for the Lord President to give.

Now I come to *McGowan's*⁽³⁾ case and I must look and see first the facts in that case. It is quite clear in the facts of that case there was no such findings of fact as here. The only evidence, if I may so call it, of a fact, is what was referred to more than once: “It is the practice of Insurance Companies to estimate the unexpired risk at any given date on yearly policies of insurance,

(1) 1 T.C., 71.

(2) 2 T.C., 551.

(3) 5 T.C. 308

“ whether against fire, sickness or accident, at 33½ per cent. of “ the total premium income of the year ”—and then in certain cases it is 50 per cent. That is all that was said; and further in that case it appeared that in dealing with their accounts the company had distributed a profit of over £60,000; whereas according to their theoretical accounts the only profit that they made was £15,000. Under those circumstances it may fairly be said that the Insurance Company in that case did not prove what they were bound to prove, namely what was the fair value of this liability in respect of unexpired risks. Those being the facts we have to see how the noble Lords dealt with it. Lord Loreburn said, “ Now in my opinion there is one sufficient reason for “ rejecting this contention. It is not found as a fact that 33½ “ per cent. does represent the real value of the risks that run “ on into 1904 in respect of premiums received in 1903. I am “ not prepared to assume that it is so, because of the statement “ of the Commissioners that it is the practice of Insurance Com- “ panies to estimate 33½ per cent. as the proper figure to repre- “ sent that value. We are not told either for what purpose such “ an estimate is made, or that it corresponds with the reality. If I am to conjecture, I should incline to the view that this per- “ centage is very far from the proper figure ”—and then he refers to the facts I have stated—“ For if this estimate be accepted, then in the three years 1902, 1903 and 1904, taken together, the total “ profit of this Company, making certain deductions, was £15,338, “ whereas we know that for its own purposes the total profit, “ after the same deductions, was treated by the Company as “ £62,850, and dividends were paid and moneys carried to reserve “ on that footing.” So that he had the strongest evidence there that in that company and dealing with that company 33½ per cent. was not the fair value of the liability for these unexpired risks. Then he says “ During 32 years, since the decision of *Imperial “ Fire Insurance Company v. Wilson*,⁽¹⁾ the method of assessing “ Fire and Accident Companies has been that adopted by the “ Commissioners in the present case. It is not scientifically “ unassailable, for it obviously proceeds upon the supposition “ that the unexpired risks at the beginning and at the end of the “ year are in substance the same, or that, if an average of three “ years is taken, they are upon the average the same ”—that puts it on exactly the proper system. Then he says “ But no method “ is scientifically unassailable that does not enter into an analysis “ of the contracts made and contracts current in each year so “ minute that it is in a business sense impracticable.” He is dealing there not with law; he is dealing there with fact and he assumes that with regard to this Company it is impossible to do it. But if persons come and give evidence that it is possible to get very near to it and if the Commissioners find that they have got sufficiently near to enable them to find as a fact that that is the proper value for the unexpired risk, I do not think there is anything in this judgment which prevents my saying that that should be the proper allowance to be made. Then Lord Loreburn

(1) 1 T.C., 71

says: "I think the particular correction sought by the Appellants in this case is indefensible upon the materials before us, and, further, that the method adopted by the Commissioners is a good working rule in the present instance and generally." That must be taken. It is: "A good working rule generally." That does not mean that it is to be adopted in every case. If there be a case where you really can arrive at the fair value instead of a rule of thumb value, there is no law, as I understand it, which prevents you taking the real value instead of a rule of thumb value. Then he says—"If in any particular case an Insurance Company can show it works hardship, no doubt the rule ought to be modified so that the real gains and profits may be ascertained as near as may be." He says:—"If it can be shown that it works a hardship." What is shown here? There is shown here that at the beginning of the three years the premiums were £1,208,000 and at the end £1,306,000. It is quite clear therefore that the unexpired risks at the end of the period were greater than those at the beginning of the period. That is shown further by the figure that is brought into the opening amount £466,000—which represents 40 per cent. of the premiums, as distinguished from the closing amount £522,000. Further, it is clear to me, demonstrated, that something more ought to be deducted from this in order to ascertain the real profits and gains. The Insurance Company have to prove what that is, I quite admit, and if they cannot prove it, then they fail in claiming that deduction. It seems to me they have proved here that if they pay according to the demands of the Surveyor of Taxes, without making any such allowance, they will be paying income tax on £18,778 too much. That is what I call a hardship. Of course that is all based upon the fact that £466,000, £489,000, £483,000 and £522,000 are as a matter of fact the real value of the unexpired risks. But in any event it seems to me they have shown here that a larger allowance ought to be made and they are paying too much.

Of course I must look at the other Judgments of the noble Lords in *McGowan's* case. Lord Ashburton says: "I concur with the Lord Chancellor." Lord Macnaghten says:—"Your Lordships would probably agree with Mr. Danckwerts in thinking that the present mode of assessing the profits of a fire insurance company for the purpose of the income tax is neither accurate nor scientific. But it has been established for a very long time. It is simple and it does not appear that in the long run it is productive of injustice. The alternative mode first proposed by the learned Counsel for the appellants is certainly not more accurate. The inquiry afterwards suggested, would, I think, be interminable." That is a question of fact and the Commissioners find that it is not an interminable inquiry because they say, "We have conducted it and arrived at a sum." Lord Macnaghten has not enunciated any proposition of law but he thinks from the materials before him it is a question of fact. Then he says:—"It is impossible to obtain anything approaching complete accuracy by any conceivable method." That again is not law; it is fact. The Commissioners tell us otherwise in this case.

“ In a somewhat similar case—it was a rating case—Mr. Justice Blackburn delivering the judgment of the Queen’s Bench, after stating that the Court had endeavoured to lay down a rule more satisfactorily than the one then in force, makes the following observations: ‘ We have not, however, succeeded in laying down a rule which would be consistent with the existing legislation and decisions on this subject and would at the same time be capable of being satisfactorily worked and we are strongly impressed with the importance of not unsettling the law as established by past decisions where we cannot lay down a rule that is not open to exception.’ ” Now it may be that other companies may fail in satisfying the Commissioners; the onus is entirely upon them; but in this case the Company has satisfied the Commissioners and I do not think I have any right to go beyond the question of fact which they have found. Lord Collins says this:—“ In my opinion the proposed method of taking the accounts of the insurance company is open to the same objections that prevailed in that case, which has been acted upon in the interval. I am far from satisfied that it arrives at a result at all more approximately accurate than the less complex method suggested by the legislature itself and adopted by the Commissioners.”

There is only one more thing that I need deal with, and that is the Act of Parliament* which has been passed. Of course that has no legislative effect upon the gains of the Companies in the past at all. It obliges them in the future to make out the accounts in a certain way and one item of those accounts is “ Reserve for unexpired risks,” and that is a deduction which must appear in the Revenue Account of the year. So that any inconvenience that may be caused by changing the mode in which Insurance Companies make up their accounts cannot be considered a matter of importance, because the legislature have said that in the future they shall do it as a matter of fact. It seems to me that is the way, and although I quite admit this Act can have no effect whatever upon this question, yet it does fortify the conclusion that I have come to, that it is a possible thing to do, because the Act of Parliament says it ought to be done and further according to the form of the accounts it can be done. I think if the noble Lords in the case of the *General Accident Fire and Life Assurance Corporation v. McGowan* had had the facts before them which I have they would have come to a different decision. Of course, I have no right to give Judgment for the Respondents here unless I thought so, but I do think that if they had had all these facts in that case they would have come to a different conclusion, namely, the conclusion at which I have arrived that in this particular case—and that is all I am dealing with—it is a proper allowance to be made.

Then the Appeal will be dismissed.

Mr. Danckwerts:—With costs, my Lord.

Mr. Justice Bray:—Yes.

* The Assurance Companies Act, 1909.

Notice of Appeal having been given, the Case was heard in the Court of Appeal on the 10th April, 1911. The same Counsel appeared as before, with the exception that Sir W. Robson had been succeeded as Attorney-General by Sir Rufus Isaacs, K.C., M.P., who appeared accordingly for the Appellant. Judgment was given the same day, reversing the decision of the Divisional Court.

JUDGMENT.

Cozens-Hardy, M.R.—We do not trouble you Mr. Attorney. This is a case in which I feel some difficulty in giving judgment, for apart from authority, I should have said without hesitation that I agree with the arguments of the Respondents in the present case, but I cannot persuade myself that it is right for me to follow what my own unassisted judgment would have thought right, having regard to what has taken place elsewhere. The question here is, put shortly, this: In the case of a fire insurance company is it or is it not right to treat the premiums received during the whole of the current year as income of that year, although part of the risks in respect of which the premiums were paid extended over into the next year? The point came before the Court of Exchequer in 1876, in *Wilson's*⁽¹⁾ case. I am quite aware of the distinction which has been sought to be raised, and properly sought to be raised, by Mr. Danckwerts between that case and this. There the Company itself had not put aside any reserve to meet the risks for the unexpired term. Then in 1889 it came before the Scotch Court and the Scotch Court, in a Judgment delivered by the Lord President, not with reference to the facts of the particular case before him but as a general rule and, as he said, as a useful guide to the Revenue Officers and the General Commissioners of Income Tax in dealing with cases of this description, decided: "Seeing that fire insurance policies are contracts for one year only, premiums received for the year of assessment, or on an average of three years, deducting losses by fire during the same period and ordinary expenses, may be fairly taken as profits and gains of the Company without taking into account or making any allowance for the balance of annual risks unexpired at the end of the financial year of the Company"; that is, if there ever was, a general rule of law applicable to fire insurance companies and with reference to the annual risk unexpired. Then came *McGowan's*⁽²⁾ case in 1907, which was before the Scotch Court. I think it is not unfair to say that *McGowan's* case was really treated as being, in substance, an appeal from the *Scottish Union* case. If you look at the Judgment of the Judges of the First Division it is, I think, quite clear that they treated it so. It was conceded that they could not prevail in that case unless they were to overrule the Judgment in the *Scottish Union* case, and Lord M'Laren, who delivered leading opinion, cited that passage from the Lord President's Judgment in the *Scottish Union* case which I have

(1) 1 T.C., 71.

(2) 5 T.C., 308.

read. Then that came up to the House of Lords, and what was the question that was raised then and brought up for the opinion of the House of Lords? I take the Appellant's case: First of all, the Appellant's case stated these reasons:—

“(1) Because in order to ascertain the trading profits of companies dealing in yearly policies of insurance it is necessary to take into account the unexpired risk on current policies. (2) Because in ascertaining the profits of such companies for the purpose of assessing income tax an allowance for unexpired risk is just and equitable and in accordance with the provisions of the Income Tax Acts,” and then “(3) Because the Judgment appealed from and the previous decisions which it follows are founded upon an erroneous conception of the limited effect of the method of ascertaining profit adopted by the assessor.” It is quite true there is a third reason which is ancillary to and subordinate to the others: “Because the rate of allowance proposed by the Appellants is fair and equitable and in accordance with the general experience and practice of insurance companies.” The Appellants there raised, in language which is perfectly clear and perfectly explicit, that in ascertaining the trading profits you must take into account the unexpired risk. The substance of that case was not whether 33½ per cent. was proper or not, but whether an allowance at all ought to have been made. Then when I look at the Respondent's case, the case of the Crown, it is “Because on a sound construction of the Income Tax Acts the Appellants are not entitled, in ascertaining, for income tax purposes, the annual profits of their business, to deduct the estimated losses on risks unexpired at the end of the year.” I never saw a case in which the propositions on either side were more clearly and explicitly stated. One said, you are bound to take into account the unexpired risks on current policies, and the other, you are not entitled to take into account the estimated loss on risks unexpired. That came up to the House of Lords, and it was argued by Mr. Danckwerts, I am quite sure with his usual energy and ability, and he not merely dealt with the general question, but he in terms said that if the 33½ is not the proper amount the proper course is to send it back to the Commissioners to find what the true percentage is; and if the House of Lords had taken the view that in a case of this kind the true percentage, the proper percentage, the right percentage for unexpired risks ought to be deducted, I am quite unable to conceive why they did not take that course; because, if I may respectfully say so, it would not be right to say that nothing whatever can be allowed in respect of unexpired risks because you have not proved that 33½ per cent. is enough. I can only say that I read the Judgment of the noble Lords as meaning and deciding that the view taken by the Court below in the Scotch Court, which was based upon a general principle and not in the least upon any inadequacy of proof that 33½ was proper—I take the Judgment of the House of Lords as assent to the argument on the part of the Crown and a dissent from the argument on the part of the Appellants. Then is it possible now for us to say that we can distinguish the present case because in the *McGowan* case no

actual deduction had been made in the accounts of the Company of 33½ per cent. or any other particular percentage, whereas here it has been proved that the Sun Office since, I think 1888, have done that which seems to me to be obviously in accordance with good management and good accountancy, namely, deducted a percentage which they estimate at 40 per cent. as an allowance for unexpired risks? There is, of course, here a finding that that is a reasonable estimate to be allowed in respect of that. I cannot think that we ought to or should be justified in attempting to distinguish this case from the decision of the House of Lords on such a ground as that. I can only bow to the decision of the House of Lords and it must be left for the House of Lords, if the Respondents are so minded to take the case there, to say whether the distinction raised in the present case is a valid distinction leading to a different conclusion from that which was arrived at in *McGowan's* case.

For these reasons, obeying to the best of my ability the rule laid down by the House of Lords, and again, as I say, not expressing my own individual view, I think this appeal must be allowed and the Judgment of Mr. Justice Bray must be set aside.

Fletcher-Moulton, L.J.—With very great reluctance I have come to the same opinion. It is a great pleasure to take part in a judicial decision in which the Court has set a good example to the mercantile community by endorsing the practice of some of the most intelligent and most honourable of its members; and it is equally painful when one feels that one is giving the stamp of judicial authority to something which one cannot support from that point of view.

In the present case we are dealing with an Insurance Company. The characteristic of insurance business is that the payments are in advance and that the risks come after the payments, and any commercial man who would treat the premiums that he receives as sums that he might put to income without making any allowance for the risks which he undertook in order to get those premiums, would be thought very little of in the commercial world. If it was a life insurance, to do such a thing would probably be gross fraud such as one sees in the insurance swindles that are immortalised in *Martin Chuzzlewit*. If it was a marine insurance it would be so grave a fault that we find in the case of the County Marine Insurance Company the Court of Appeal in Chancery compelled the directors who had treated the premiums so received as merely revenue and paid dividends out of them without making proper allowance for the risks to be covered, as having been guilty of such improper conduct that they had to refund to the Company the money so paid out. Fire insurance does not differ from that excepting that it is much more simple and easy in fire insurance to make allowance for future risks. Roughly speaking, they may be proportioned to the period covered by the premium which has not expired, and, therefore, I think that in fire insurance the companies ought in that way, or if practice had enabled them to guess what a calculation on that basis would lead to, by the adoption of some rough and ready method, to provide in their balance sheets for the unexpired

risks. My opinion in this respect, which I do not think any commercial man would quarrel with, is absolutely confirmed by the action of the legislature in the Insurance Companies Act of 1909, which in the Schedule prescribes the balance sheet that is to be drawn up by every fire insurance company, and there is a provision for these unexpired risks, and it intimates by the form of the entry that it is intended that those should be calculated, as they are in the case before us, by a percentage on the total premiums received. Therefore, we have it that by our own reasoning, by the action of the legislature and I think by the action of all commercial men, the proper way to ascertain profits in fire insurance companies is to make a reserve for unexpired risks. In the circumstances I should not have the slightest hesitation in supporting Mr. Justice Bray's decision if it were not that I feel compelled by authority to decide the other way.

It is rather important to see how authority came to be so strongly at variance with, if I might say so, the reason of the subject. The point has been very unfortunate in respect of the cases in which it has been litigated, which commence with *Wilson's* case which came before the Court of Exchequer in 1876. There a company that had been drawing up its own domestic balance sheets without any reserve for unexpired risks, claimed before the Commissioners of Income Tax to be entitled to deduct one-third from the premium income and set that off against the unexpired risks. The Court there consisted of Chief Baron Kelly, Baron Amphlett, and Baron Huddleston. The last two decided distinctly on the facts of that case, basing their decision very much upon this, that the Company itself by its action had discredited the system that they wanted the Crown to accept in the assessment of income tax. Chief Baron Kelly, I think, went further, but I cannot say that I agree with the argument which he embodies in his Judgment. His phrase with regard to the premiums paid is that "at the moment they are profit." With the greatest respect for Chief Baron Kelly I think that that is a phrase which ought not to commend itself to any person who thinks of the real meaning of the word "profit"; a premium is certainly not at the moment when it is received profit. The decision, however, was against this deduction, and the consequence of that was that the profits of that Company were taken without making any allowance for future unexpired risks, and, apparently the commercial world accepted that as a decision that that was the proper way of calculating the profits of such a company. I do not think the Judgment went anything like so far as that; in fact all that it amounted to was, you, the Company, have not supported the way you propose to have your profits calculated and, therefore, we must fall back on that which the Crown insists on. The method of calculating the profits without making any allowance for unexpired risks was rather *fucum facere* than anything else, but in text books and in the practice of the Company it became recognised, from that time on, that the proper way of calculating the profits was without making allowance for unexpired risks. In Scotland, apparently, some years afterwards, in 1889, it was challenged in the *Scottish*

Union and National Insurance Company's case. By that time the rule had been accepted for more than a dozen years, and once more a company came that could not show that it had drawn up its own domestic accounts in the way that it was trying to get the Crown to allow it to calculate profits. There again, I think the moral disadvantage at which they stood in their argument on account of those facts led the Court to decide against them, and once more the imperfect method of calculating profits without allowing for unexpired risks got judicial sanction, and I think that the language of the Judges there went very far to treat it as being in the eyes of the law the proper way in which those profits ought to be dealt with. Neither of those cases would have bound us, and speaking for myself, in spite of the long time that this rule has practically been accepted, I could not have brought myself to sanction it if it were not that a third case, which I think the Master of the Rolls properly characterised as intended as an appeal from the *Scottish Union* case, was brought and carried up to the House of Lords. Unfortunately there again the Company that claimed to be allowed to make this provision against unexpired risks had not done so in its own domestic accounts, and what is more, it did not prove that that was the right allowance to be made. It simply based its claim on the fact that it was usual in companies to make that reserve. When you come to look at the balance sheets that were before the House of Lords it is quite clear that the general reserve fund and the reserve fund for unexpired risks was mixed up, the amount varied from time to time with increasing business, but it was quite obvious that they did not follow the rule themselves which they asked the House of Lords to accept. Again I think that that fact led to their defeat; but each time the Court has used stronger language of acceptance of the certainly incorrect rule that had held the field ever since 1876, and, reading the decisions in the House of Lords with the feeling that I am bound by them and although it might have been that if the history of the litigation had been different a different result would have been arrived at, yet certainty in law is a thing of great importance and I do not feel that, sitting here as a member of an inferior Court, I could interpret the decision in *McGowan's case* as other than a judicial approbation of the method of calculation which was approved of by the *Wilson* judgment, and I do not feel that in spite of my deeply rooted objection to it, in spite of my feeling that it is not an interpretation of the word "profits" as applied to fire insurance companies that ought to receive judicial approbation, I think that the past has been such that no Court has authority to alter the status of the rule except the House of Lords. I sincerely hope if this case goes to the House of Lords they will feel themselves capable of putting the matter on a more satisfactory footing. In my opinion it is quite easy to calculate by apportionment the amount of premiums that ought to be set aside for unexpired risks, but I also think that the accuracy of averages is such that the method of taking a proper percentage of the premium income for that purpose is so nearly accurate that no Court ought to object to receiving it instead of the strictly accurate method of apportionment. It therefore

follows that, so far as my individual opinion is concerned, there is no objection in the way of impracticability, and there certainly is no objection on the ground of principle, to the adoption of the system of allowing for unexpired risks such as is contended for in the present case by the Appellant.

Buckley, L.J.—I heartily wish that I felt myself at liberty to give effect in this case to my own conviction. I could give reasons for distinguishing this case from *McGowan's* case but I mistrust myself in so doing. A judge who has the misfortune not to agree with a decision which binds him is necessarily suspicious of himself in relying upon reasons for distinguishing the case before him. Further, I think there is great force in the contention that in *McGowan's* case the House were not laying down any principle of law; they were, however, seemingly approving a general working rule in income tax cases of this description and it is a sound principle that the law should as far as possible be rendered certain. On the whole I think it better that this case should go before the House of Lords, leaving it to them to say, firstly, whether in *McGowan's* case they were determining any principle of law at all; and, secondly, if that is answered in the affirmative, whether under the circumstances in which, as it seems to me, this case differs from that, the working rule which they approve is applicable or not.

Mr. Finlay.—The appeal will be allowed with costs?

The Master of the Rolls.—Yes.

The case was taken by the Company, on appeal, to the House of Lords, and was argued before their Lordships on the 23rd January, 1912. The same Counsel as before appeared for the Company, and the Attorney-General (Sir Rufus Isaacs, K.C., M.P.), and the Solicitor-General (Sir John Simon, K.C., M.P.) appeared for the Crown.

Danckwerts, K.C., argued that this case was different from every case that had gone before. The insurances in question were not only yearly insurances, but many of them were over a series of years. The Company had for over twenty years followed the practice, in estimating their profits for the purpose of arriving at a dividend, of making a deduction in respect of unexpired risks. The proportion to be deducted was pronounced by eminent commercial authority to be correct, fair and reasonable.

Bremner submitted that as soon as it was established that in *McGowan's* case the facts were so materially different as they were from the facts then before their Lordships, it was impossible to treat *McGowan's* case as laying down any principle of law which bound their Lordships on that occasion. When *McGowan's* case is examined, the House were dealing with the facts before them, and upon those facts it was impossible to come to any other conclusion. The decision was with regard to the facts in that case, and their Lordships did not intend on that occasion to lay down a rule which should be treated as binding in every case.

Lord Loreburn, L.C.—Certainly for my part I did not intend to lay down any hard and fast rule, and I thought I said the contrary.

Bremner.—That is my submission to your Lordships.

Sir Rufus Isaacs, A.-G., argued that in order to ascertain the profits of a fire insurance business the premium receipts should in strictness be set against the losses incurred under all policies affected in each year of trading, and that in default of ascertaining the profits in this way, upon the actual facts, the Company were not entitled to set up any merely estimatory method of ascertaining profits against that which had been laid down by their Lordships, in *McGowan's* case, as the correct rule. He submitted that *McGowan's* case did lay down a rule of law. That rule had not been found productive of hardship in practice, notwithstanding that there must be in every insurance company some amount which is carried forward to the next year, and that such had been the case in every one of the cases during the last thirty-two years or more in which the rule has been thought to be a rule of law.

Lord Loreburn.—I do not recall (although I may be wrong) any case in which it was proved that to apply what is called a working rule would work, in fact, injustice in that case If that is so, the reason why this rule was not assailed was because no one said it worked an injustice in any particular case.

Sir Rufus Isaacs instanced the judgment of Baron Amphlett in *Wilson's* case as dealing with the hardship caused by the working rule in the case of an increasing business.

Lord Loreburn.—The whole thing is this: This is all right and fair in this case. Putting it roughly it is a good working rule, but you may change it afterwards. I think that is what Baron Amphlett said.

Lord Haldane.—Baron Huddleston says the Insurance Company might take the course taken here and then it would have been all right; but they have not done it.

Lord Loreburn.—Yes, that is what has been decided—a series of decisions on facts.

Sir John Simon, S.-G., K.C., argued that the allowance sought was an approximation not more accurate than the working rule, and that there was no justification for substituting the one for the other.

Lord Loreburn.—Of course, here you see we have a very strong finding that we are entitled to do it, and it is a reasonable and proper allowance for the very thing in question.

Sir John Simon.—That is quite true.

Judgment was given on the 7th March, 1912, in favour of the Company with costs.

JUDGMENT.

Lord Loreburn, L.C.—My Lords, in this case Mr. Justice Bray decided in favour of the Sun Insurance Company in a very convincing judgment. The Court of Appeal, while thoroughly

agreeing with him, reversed that judgment solely upon the ground that they felt obliged to do so by the decision of this House in *McGowan's* case. I am very glad that this appeal has been brought, because no one could be more surprised than myself at the view taken of that decision by the Court of Appeal. Let me endeavour to explain my reason.

When a fire insurance company is to be assessed for income tax the main point to be ascertained will be what has been the gain or the loss upon the contracts of insurance which it has effected in each of the three years which are taken to make the average.

If it were practicable, the accurate way, I suppose, would be to add together the premiums which the Company became entitled to receive in each year, say 1903, upon contracts made in that year, and then to add up the losses which the Company became bound to pay upon those contracts made in the year 1903. The difference between these two sum totals would show precisely what was the gain of the Company or their loss in respect of the contracts made in the year 1903.

But this is impracticable because contracts of fire insurance are made all through the year, from first January to thirty-first December, and most of them, or at all events many of them, are made to cover fire risks for a year, some, we are told, for five or six or seven years, from the date of their making. The premium is paid in advance. So the result in the way of gain or loss could not be ascertained as a fact until after the period of time had elapsed. Now the tax collector cannot be asked under the Income Tax Acts to wait till the end of that period. I must apologise for putting it at so great length but really the weight of the judgment appealed against makes it necessary.

Thus it appears that you cannot base the assessment of income tax upon the actual facts of the business done and the actual pecuniary results of it in the case of Fire Insurance Companies who take single premiums to cover risks for a year or for more years. This is such a Company, and I believe nearly all Companies are in the same position.

If that be so, it follows that in assessing such Fire Insurance Companies, you must proceed wholly or in part by estimate.

An estimate being necessary and the arriving at it by in some way using averages being a natural and probably inevitable expedient, the law, as it seems to me, cannot lay down any one way of doing this. It is a question of fact and of figures whether what is proposed in each case is fair both to the Crown and to the subject.

In *McGowan's* case, to which reference is made, three methods of estimating these gains or profits were before the House. I place first, merely for convenience sake and not for its importance or value, a faint suggestion which was made in the case of *McGowan*, and which as I understood it, was as follows:—It was suggested that each contract of insurance made during a particular year should be considered separately. If it had expired then the actual result should be taken, whether profit or loss. If it had not expired then an estimate should be made, having

regard to the period unexpired and the degree of risk, which might be different (in summer and winter for example) during that period.

I do not imagine that either the Crown or the Company would seriously desire such an enquiry. I do not know how many fire insurances are effected by a great Company within a twelvemonth, probably scores of thousands or even hundreds of thousands. Such a process, as to the unexpired contracts, would be minute and almost interminable. It was rejected because there was no evidence that it would be a reasonable way of ascertaining what was desired.

The second method suggested in that case was that of merely taking for each year the sum total of the premiums received and the sum total of the losses paid and subtracting the one from the other, without regard to the fact that the premiums cover risks running on into subsequent years and the losses include losses arising out of contracts made in previous years. This method is of course not precise or scientific. It proceeds upon the view that when this is done for the three consecutive years indicated by the Statute and the figures thus reached are averaged, a fair and reasonable conclusion is attained.

This method was adopted long ago and has more than once been the subject of consideration in courts of law. I can conceive it being unfair either in the case of a rapidly increasing or of a rapidly diminishing fire insurance business. It may prove unfair in other cases. But in *McGowan's* case it was not proved to be unfair. On the contrary it closely corresponded with the dividends actually distributed and was upon the facts of that case clearly the most accurate and reasonable of the methods which alone were propounded for our consideration. Accordingly it was adopted.

I think it is in general a good working rule, but no one in this House has said that it ought to supersede the truth if the truth is in conflict with it in any case.

A third method, similar in principle to that advanced by the now appellants, was also considered by your Lordships in the case of *McGowan*. This method is to carry forward annually at the close of the year a percentage of the premium income in order to allow for unexpired risks. It has no pretensions to being precise. I can easily imagine cases in which an actuary could show it was misleading. But if it comes nearer to the truth than any other method in a particular case, I do not understand why it should not be adopted.

This third method, however, in its application to that case, the *McGowan* case, would have meant that the Insurance Company was to pay income tax upon the footing of about £15,000 profits and gains in the three statutory years, whereas they had divided dividends of about £60,000 in those three years. And there was no evidence and no finding, nor could there honestly have been, that the third method worked fairly between the Crown and the subject.

In those circumstances this House rejected the third method. The House adopted the second, but so far from laying it down

as a rule of law, it was expressly pointed out that the second method was of itself imperfect and, though a good working rule generally, would not be applicable if in any case it appeared upon the facts to involve hardship. The head note in the Law Reports is quite wrong and the view of Mr. Justice Bray of what the House decided in *McGowan's* case is accurate.

After this preface, tedious but necessary in the circumstances, I come to the merits of the present appeal. Here again there is a competition between two methods of estimate. That which I have called the second is propounded by the Crown; that which I have called the third is propounded by the Company, who deduct 40 per cent. of the premiums at the end of each year. The relevant facts are here the reverse of what they were in the case of *McGowan*. The third method has been examined by the Commissioners and is stated in the Special Case to be right in this case. It was in terms admitted by the Surveyor of Taxes before the Commissioners that the fair and reasonable allowance for this Company to make if entitled to make any allowance was 40 per cent. The Surveyor's point was that no allowance or deduction at all ought to be made, because he said the proper method according to law was the second method. He did not prove, or try to prove, that it was fair in this case. So that all the evidence and the finding in the present appeal was in support of the Appellants' contention. In these circumstances it seems to me quite obvious that the third and not the second method must be applied here for the plain reason that upon the materials before us it is the fair and only way presented to us by which the truth can be approximately attained.

In the hope that it may help to prevent future misunderstanding I will recapitulate my own opinion. There is no rule of law as to the proper way of making an estimate. There is no way of estimating, which is right or wrong in itself. It is a question of fact and figure whether the way of making the estimate in any case is the best way for that case. Experience seems to have satisfied Courts of Law for a considerable time that the method which I have described as the second is a useful working rule. But no one has said in this House that there is any constraint to accept it. It may be that the character or mode of carrying on this insurance business may alter or may have altered, and what was a good method once may become inaccurate or even obsolete.

I am equally anxious that your Lordships should not be supposed to have laid down that the method applied by the Commissioners in the present case has any universal application. If the Crown wishes in any future instance to dispute it they can do so by evidence, and it is not to be presumed that it is either right or wrong. A rule of thumb may be very desirable, but cannot be substituted for the only Rule of Law that I know of, viz. : that the true gains are to be ascertained as nearly as it can be done.

I think this Appeal must be allowed.

Lord Haldane.—My Lords, income tax is imposed by the Income Tax Acts upon the profits or gains (calculated according

to averages) arising from business, certain deductions being prohibited, especially by the rules of the Cases in Schedule D., none of which prohibitions affect the question that arises on this appeal. It is therefore necessary to ascertain in the first instance whether the claim of the Crown in the present proceedings is confined to the profits and gains which the Statutes prescribe as its legitimate subject matter.

The Appellants carry on the business of fire insurance. It has been their practice to carry forward annually 40 per cent. of their yearly premium receipts in order to bring about the correct proportion, as between year and year, of the premium income which has to answer to the annual incidence of fire losses and on the balance of which income over or under the losses or charges for the year the profit or loss attaching to their business depends. If the premium income were stationary this would make but little difference as regards income tax, for a uniform amount deducted would be carried forward to profit in the ensuing year. But the business of the Appellants and their premium incomes are increasing, with the result that the amount escaping the tax in each year varies progressively. The Commissioners of Taxes in the City of London, after examining the case, were of opinion that the percentage carried forward in each year was a reasonable and proper allowance and did not form part of profits or gains for the year. The Surveyor admitted that he was not in a position to contest that the percentage carried forward was accurately estimated, but contended that the Appellants were liable in respect of the entire premium income, on the ground that the Courts had laid down that no such deduction was permissible. A case was stated for the opinion of the High Court of Justice, and Mr. Justice Bray decided in favour of the Appellants. The Court of Appeal reversed his Judgment and decided in favour of the Crown, on the ground that they were bound by the decision of this House in the case of *The General Accident, Fire and Life Assurance Corporation v. McGowan* (1908 A.C. 207).

It is plain that the question of what is or is not profit or gain must primarily be one of fact and of fact to be ascertained by the tests applied in ordinary business. Questions of law can only arise when (as was not the case here) some express statutory direction applies and excludes ordinary commercial practice, or where, by reason of its being impracticable to ascertain the facts sufficiently, some presumption has to be invoked to fill the gap. Such a presumption was made in the Appeal referred to, where, as pointed out in the judgment delivered by the Lord Chancellor, it was not shown that the percentage deducted represented the real value of risks yet to run and was so unearned, and where it appeared further that the Company had actually divided the entire amount without deduction among its shareholders as part of the profit of the year. In *The General Accident, Fire and Life Assurance Corporation v. McGowan* it was therefore, in the absence of evidence to the contrary, presumed that the whole of the premium income received in the year represented income earned by bearing the risks of the year. It is difficult to see how, on the materials before the House, the decision could have

been otherwise, but it seems to me equally clear that the reason of the decision has no application where, as here, it has been accurately ascertained that part of the premiums are not in the nature of profit earned. As Mr. Justice Bray puts it, the case is analogous to one in which if goods are bought their value cannot be treated as profit without deducting the value of the liability to pay for them which the buyer has incurred. Such cases as *Imperial Fire Insurance Company v. Wilson* (35 L.T. 271, 1 T.C. 71) and *Scottish Union and National Insurance Company v. Smiles*, and *Northern Assurance Company v. Russell* (2 T.C. 551) are not, when carefully examined in the light of what appears to be the true principles, reliable as authorities for a proposition which would run counter to the practice and good sense of the commercial community. The Judges in the Court of Appeal appear to have thought themselves bound to hold that this House had laid down a rule of law so rigid that, although introduced for the purpose of supplying deficient evidence of fact, it must still apply even when there was no deficiency of proof. I have come to a different conclusion. I think that Mr. Justice Bray has correctly interpreted the decision in question when he says that if in the earlier case such facts had been before this House as have been established in the present case, it would, in his opinion, have decided against the Crown. The present Appeal ought, in my judgment, to succeed.

Lord Alverstone.—My Lords, this is an Appeal by the Sun Insurance Office against the decision of the Court of Appeal reversing a decision of Mr. Justice Bray.

The question raised by the appeal is as to the right of the appellant Company in estimating the annual profits or gains for the purpose of the Income Tax Acts, to make a deduction in respect of premiums on policies still current at the end of the financial year.

The facts are not in dispute. The Appellants issue policies for periods of twelve months and possibly longer; the risks on these policies run not from a fixed date but from the dates named in the policies, which may be any day in the year; in consequence, at the end of the financial year there are invariably a considerable number of policies still running, in respect of which the Appellants are still under liability to pay should any loss occur.

The Appellants claimed that inasmuch as the premiums on such policies cover a period beyond the financial year, the total amount of premiums on such policies cannot be treated as ascertained profits, as the Company may be called upon to pay losses under and by virtue of the contract still existing.

It is not disputed that as a matter of principle the claim of the Appellants is well founded. Premiums are not profits or gains, they are receipts which must be brought into account and out of which, after proper deduction for losses, profits will accrue. If the actual amount of the premiums received in any financial year were substantially constant the assessment of gains and profits after the second year would not be affected; but the

business of the Appellants was an increasing business and for the three years 1902, 1903 and 1904 the total increase of premium income averaged £18,778.*

The only matter in dispute was the right of the Appellants in estimating the profits or gains to make a deduction in respect of the outstanding premiums due to increased business during the three years under consideration. The matter was investigated by the Commissioners of Income Tax, who, after hearing evidence, were of opinion that the Company were entitled to carry forward a percentage of fire premiums in one year in respect of unearned premiums which did not form part of the profits of the year. It was not disputed by the Surveyor of Taxes that if the Company were legally entitled to such an allowance, he was not in this Appeal in a position to contest that 40 per cent. was an accurate estimate to reserve, and the Commissioners found as a fact that in the case of the Sun Fire Insurance Office 40 per cent. was a reasonable and proper allowance. It was not seriously contested by the Attorney-General that on principle the Appellants were entitled to make some deduction, but he contended that as a matter of law no deduction was permissible in respect of unexpired risks, and he further contended that the decision of your Lordships' House in the case of the *General Accident Insurance Company v. McGowan* (1908 Appeal Cases 207) had laid down as a principle of law that no such deduction could be permitted. With regard to the justification for such a deduction it is quite unnecessary to state any reasons. Mr. Justice Bray and the members of the Court of Appeal have expressed in the strongest terms their opinion that some such deduction ought to be made. The only question therefore requiring consideration is whether there is any rule of law or any decision of your Lordships' House which prevents the Appellants being entitled to claim such a deduction.

The question of what are profits or gains within the meaning of the Income Tax Act is *prima facie* a question of fact, and if the cases from *The Imperial Life Insurance Company v. Wilson* (35 L.T. 271) in the year 1876, down to *The General Accident Insurance Company v. McGowan* in the year 1908 be examined, it will be found that in every case the Courts have treated the question as one of fact and have merely decided whether upon the facts before them the claim of the taxpayer to make a deduction in a particular way was justified. The Attorney-General contended that no estimate was permissible in arriving at the amount to be deducted and he based this argument principally on the language of the judgment of the Court of Exchequer in *The Imperial Fire Insurance Company v. Wilson*, and the language of the Lord President in the case of *The Scottish Union v. Inland Revenue* (16 R. 461) cited in the Judgment of the Master of the Rolls, but in each case, if properly examined, it will be found that the Court were dealing with a question of fact and were only approving that which in their judgment

* So in the judgment. The average £ 8,778 was, however, only the increase in the 40 per cent. of premium income set apart as a reserve in those years.

appeared to be the best solution of that question, the method which had been approved in the case of *The Imperial Fire Insurance Company v. Wilson*. Coming now to the case upon which express reliance was placed by the Respondents, who in their case state that it is governed by the decision of your Lordships' House in *McGowan's* case, in that case the mode of estimating the proper deduction put forward by the then Appellants was rejected by your Lordships' House as being absolutely unjustified upon the facts. See the judgment of the Lord Chancellor at page 212, who decided that the particular correction sought by the Appellants in that case was indefensible upon the materials before the House, and that the method adopted by the Commissioners was a good working rule in the then present instance and generally. But your Lordship the Lord Chancellor went on to say that if in any particular case an insurance company could show that it worked hardship, the rule ought to be modified so that the real gains and profits might be ascertained, as near as may be. It is said that Lord Macnaghten in his judgment went further, but I have seen nothing to lead me to believe that Lord Macnaghten was purporting to lay down any rule of law; he was, in my opinion, only expressing very strongly his view upon the facts then before your Lordships' House.

I adopt the reasoning in the judgment of Mr. Justice Bray, who considered that, properly understood, the case of *The General Accident v. McGowan* was a decision upon the facts and not on law, and I am unable to agree with the decision of the Court of Appeal that your Lordships intended to lay down any binding rule that as a matter of law no such deduction could be allowed. For these reasons I am of opinion that the decision of the Court of Appeal should be reversed and the judgment of Mr. Justice Bray restored.

Lord Atkinson.—My Lords, in this case the learned Lords Justices in the Court of Appeal apparently considered themselves coerced by some rule of law, supposed to have been laid down in your Lordships' House in the case of *The General Accident Fire and Life Assurance Corporation Limited v. McGowan* (1908 Appeal Cases 207) to pronounce a decision repugnant to their own sense of right and justice.

Speaking for myself, I feel bound to say, with all respect, that I find great difficulty in seeing how, if that case be examined in a fair and reasonable, though critical spirit, it can be supposed that in it any rule of law was laid down, or anything decided as a matter of law. Two different practical methods for ascertaining the profits and gains of the Appellant's business for the purposes of the Income Tax Acts were suggested and insisted upon by the respective parties in the case. The method insisted upon by the Appellants led, on the facts, to grotesque results, while that insisted upon by the Respondents, which was the same as that contended for by the Crown in the present case, led to comparatively accurate and just results. This latter was proved to be the usual method, and was considered to be simple, practical, and easily applied. A third method was suggested

which was not practical. Your Lordships had to choose between the two practical methods and you choose that which led to the just results.

That, however, is a very different thing from deciding, as a matter of law, that the method so approved of was the only legal method which could be adopted in such cases, or that deductions were never to be made from the premiums received on fire policies in respect of risks unexpired at the time the yearly accounts of the Company were made up. A little consideration of one of the most illuminating authorities in the books upon this question of the mode of ascertaining the taxable gains and profits of trading and commercial businesses, namely, *Gresham Life Assurance Society v. Styles* (1893 Appeal Cases 309) will show conclusively that, consistently with that authority, no such rule could be laid down as a matter of law. The very nature of the thing forbids it. That case clearly decided that the receipts of a business are not in themselves profit and gains within the meaning of the Income Tax Acts, but that it is what remains of those receipts after there has been deducted from them the cost of earning them which constitute the taxable profits and gains. Now what is the service which a Fire Insurance Company renders to each insurer in consideration for the premium it receives? It is only by rendering this service in each case it earns these receipts. The service consists in indemnifying the insurer against loss by fire during the continuance of his policy. The Company are entitled to deduct what it will cost them to perform that service. In any given case where a fire occurs the loss, and therefore the cost of the service by which the premium is earned, may and almost certainly will vastly exceed the premium, but in the aggregate of all their policies the aggregate cost will, of course, be much less than the aggregate premiums. The difficulty of the position consists in this, that, until the time for which a policy is to remain effective has expired, nobody can tell precisely how much the service will cost. Yet until that time has expired the service for which the Company has been paid has not been completely performed. If the accounts of the Company are to be rendered before the date of expiry, then some division of the premium must be made, and the proportion to be appropriated to the service which is to be performed thereafter. I think the description "unearned premium" which has been used to describe this latter portion is a very appropriate and accurate description.

It is obvious that the entire premium cannot in every case be divided in the same proportions as those into which the accounting period divides the entire duration of the policy, because the risk is not the same for each calendar month or each season. On the contrary, the risk is admittedly greater in the winter months than in the summer months, because fires and artificial light are more used in the former than in the latter; for instance if the 31st of December be the accounting day and the policy be effected on the 1st of July, it might be quite right to divide the premium into two equal portions, one half being treated as earned in the year the policy was effected, and the other half

as to be earned in the succeeding half year, but if the policy were effected on the 1st of October then it would, obviously, be unfair, on account of this greater risk, to treat only one quarter of the entire premium as having been earned in the three winter months of October, November and December. Having regard, therefore, to the fact that companies carrying on this kind of business are, under the decision of your Lordships' House, clearly entitled to object to their receipts being treated *per se* as their profits and gains without the proper deduction having been made of the cost of earning those receipts, it is obvious that the amount of the taxable profits and gains can only be ascertained by some system of averages or estimation, or by some other practical rule of thumb based upon experience and the facts of different cases.

As I understand, Lord Justice Moulton is of opinion that some method might be adopted by which the problem could be solved with scientific accuracy. Unfortunately he does not describe in detail what that method is. It may, for all that appears, involve such complicated calculations in reference to each particular policy as to be practically unworkable, and certainly it does not appear to me that it is possible to adopt any method which does not involve recourse, at some stage of its processes, to estimates, averages, or such like things. If these matters be borne in mind, it does seem strange that it should have been supposed that it could ever have been laid down as a matter of law that one method, and one method alone, could legally be employed to solve the problem.

Now, to turn to a detailed examination of *McGowan's* case. If any meaning is to be given to words, no ingenuity can find in the Judgment of the Lord Chancellor anything equivalent to a statement that, as a matter of law, only one rule, or method, could be applied to reach the desired result. On the contrary, at page 212 of the Report he is reported to have used these words:—"I think the particular correction sought by the Appellant in this case is indispensable upon the materials before us, and, further, that the method adopted by the Commissioners is a good working rule in the present instance, and generally. If, in any particular case, an insurance company can show it works hardship, no doubt the rule ought to be modified so that the real gains and profits may be ascertained as near as may be. I am for dismissing the Appeal." That clearly means this, that the method adopted by the Commissioners is not the only method which can be legally adopted, but is a good working method for general use, to be departed from where it is shown to work injustice.

Lord Ashbourne said he concurred with the Lord Chancellor. That may mean that he merely concurred in the conclusion at which the Lord Chancellor had arrived, or that, in addition, he adopted every word the Lord Chancellor had said. I understand that, according to the practice of your Lordships' House, mere concurrence as Lord Ashbourne expressed it, conveys the former meaning, not the latter. Lord Macnaghten then delivered judgment. It is contended that his judgment amounts to a

decision that the rule adopted by the Commissioners is the only rule which can legally be adopted in such cases, to ascertain the amount of the taxable profits and gains.

I do not myself think that a fair and reasonable construction of Lord Macnaghten's language leads to any such conclusion; but if I am mistaken in that view, then it cannot be disputed that the conclusion at which he arrived (quite unnecessary for the decision of the case) is the very contrary of that at which the Lord Chancellor arrived. The one noble Lord says in effect that the rule is not a rule of law at all, but is generally a good working rule, to be departed from when it is shown to work injustice. And the other lays it down that it is the only legal rule, is to be invariably applied, and can never be departed from whether it works injustice or not. No two statements could be more irreconcilable. Well, Lords James of Hereford and Robertson, and I myself then stated we concurred; but concurred with what or in what? I know their minds were too logical, and I hope my own mind was too logical, to agree at the same moment with each of two contradictory and irreconcilable propositions. We must therefore either have considered that the two judgments meant the same thing, or our concurrence must have been limited to a mere concurrence in the result arrived at by both our colleagues without adopting the precise language of either.

It is, I think, plain, that Lord Collins in his judgment, delivered after our concurrence had been expressed, did not use any language from which it could be fairly or legitimately inferred that, in his view, the rule approved of by the Lord Chancellor was the only rule which could be legally applied in such cases. I am, therefore, clearly of opinion that this case of *McGowan's* is no authority whatever for the proposition that the rule adopted so reluctantly by the Court of Appeal is the only legal rule which can be applied for the purpose indicated. If the Court of Appeal considered, as apparently they did consider, that case was an authority for such a proposition binding upon them, they were in my view, with all respect, entirely mistaken. It was, I think, quite open to them to approve of a different method of ascertainment which would lead to what they considered true and just results. In this particular case it is shown upon the evidence that the method contended for by the Appellants is, in this instance at all events, a better method, juster and more satisfactory in its application and results, than that insisted upon by the Commissioners. It should, therefore, I think be approved of and applied in preference to the latter. I accordingly am of opinion that this Appeal should be allowed with costs.

Questions put.

That the Order appealed from be reversed.

The Contents have it.

That the Respondents do pay to the Appellants their costs here and below.

The Contents have it.
