

No. 47\*.—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION).—  
14TH AND 15TH MAY, 1923.

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COURT OF APPEAL.—19TH, 20TH AND 21ST FEBRUARY AND  
7TH MARCH, 1924.

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HOUSE OF LORDS.—29TH AND 30TH JANUARY AND 19TH FEBRUARY,  
1925.

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THE GLOUCESTER RAILWAY CARRIAGE AND WAGON CO., LTD. v.  
THE COMMISSIONERS OF INLAND REVENUE.<sup>(3)</sup>

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*Corporation Profits Tax—Company manufacturing wagons for  
sale or hire—Whole stock of wagons used for hire sold at a profit  
—Whether capital accretion or profits of trade—Finance Act,  
1920 (10 & 11 Geo. V, c. 18), Sections 52 and 53.*

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<sup>(1)</sup> Page 657 *ante*.

<sup>(2)</sup> Page 705 *ante*.

<sup>(3)</sup> Reported K.B.D., 129 L.T. 691, C.A., 131 L.T. 595, and H.L., [1925]  
A.C. 469.

*The Appellant Company was formed to manufacture, buy, sell, hire and let on hire, wagons and other rolling stock, and for many years it manufactured railway wagons, either selling them outright or on the hire-purchase system or letting them on simple hire. In the books of the Company the wagons built to be let on hire were capitalized at a sum which included an amount added as profit on manufacture, and year by year an amount was written off the value of the wagons for depreciation. In 1920, following on a decision to cease letting wagons on hire, the Company sold off the entire stock of wagons used in that branch of its business for a sum in excess of the value of the wagons in the Company's books.*

*That surplus was included in an assessment to Corporation Profits Tax on the Company in respect of the profits of its business, and the Company appealed contending that the surplus arose from the realisation of capital assets used in its hiring business.*

*The Special Commissioners found that the object of the Company's trade was to make a profit out of wagons, that the transactions in question were not of a capital nature, and that the surplus was properly included in the assessment.*

*Held, that the surplus was not a capital increment, and was properly included in the assessment.*

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CASE

Stated by the Commissioners for the Special Purposes of the Income Tax Acts under the Finance Act, 1920, Section 56 (6), and the Income Tax Act, 1918, Section 149, for the opinion of the High Court of Justice.

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held at Gloucester on 11th March, 1921, the Gloucester Railway Carriage & Wagon Company, Limited, whose registered office is situate at Bristol Road, Gloucester (hereinafter referred to as the Company), appealed against an assessment to Corporation Profits Tax made upon them in the sum of £4,321 15s. for the accounting period from 1st January, 1920, to 31st May, 1920, by the Commissioners of Inland Revenue under the Finance Act, 1920, Part V, in respect of the profits of its business. The sole question at issue is whether a sum of £148,651 10s. 9d. hereinafter mentioned should be included as a trade receipt of the Company for purposes of computing its liability to Corporation Profits Tax for the accounting period in question.

1. A Company (hereinafter referred to as the old Company) was incorporated on 4th February, 1860, under the name of the Gloucester Wagon Company Limited. The third paragraph of the Memorandum of Association of the old Company provided that the objects for which the Company was established were "The construction, repair, maintenance, sale, purchase, hiring and letting of railway wagons and carriages and other rolling stock and the doing all such other things as are incidental or conducive to the attainment of the above objects." This business has since then been carried on upon a large scale at Gloucester.

2. The original prospectus of the old Company stated :—

"The increasing traffic in English Railways and the extension of railway enterprise at home and abroad have entirely gone beyond the supply of railway trucks and rolling stock, notwithstanding the formation of several Wagon Companies. The Railway Companies very often cannot, and for some descriptions of merchandise will not, supply trucks. It is, therefore, found that the most advantageous course open to the freighter is to hire trucks under a contract for keeping them in repair. It is therefore proposed to form such a Company under the provisions of the Joint Stock Company's Act for the construction, export, maintenance, and hiring out of railway trucks."

3. The first report of the Directors for the year to 31st December, 1860, shows that 217 wagons, of which 119 already had been constructed, had been let on simple hire, and it is stated therein that the Company's wagons had been constructed with the greatest care and attention, no necessary expense being spared to secure the best materials and workmanship, on the ground that the more substantially the wagons were built the less would be the cost of maintenance.

4. The second report refers to the "large sum which has already been invested in wagons let on hire."

5. Reports of the Directors from time to time show that the numbers of wagons let on hire were :—

in 1862	...	...	...	701	wagons
in 1863	...	...	...	738	"
in 1864	...	...	...	902	"
in 1865	...	...	...	1,404	"
in 1866	...	...	...	1,659	"

6. Besides constructing wagons to be let on hire, the old Company also constructed wagons and rolling stock for sale on the deferred purchase system.

The Directors' fifth report states that "the business of this Company has been almost entirely confined to building and selling wagons and carriages on deferred payment." Over the period covered by the Directors' reports from 1862 to 1866 inclusive the number of wagons shown on the Company's books as sold on deferred payment are :—

1862	...	...	...	...	2,311
1863	...	...	...	...	3,287
1864	...	...	...	...	3,596
1865	...	...	...	...	5,205
1866	...	...	...	...	5,525.

7. In the year ended 30th June, 1888, the number of wagons let on hire was 5,436 and the number of wagons sold on deferred payments was 3,232. For this year the Directors reported that the wagons let on hire and valued in the old Company's books at £217,189 3s. were according to a valuation made under their directions worth only £95,369, and that it was necessary to effect a reduction of the old Company's share capital.

It was accordingly decided to reconstruct the old Company and this was effected by a voluntary liquidation of the old Company, and the incorporation on the 14th September, 1888, of a new Company, which is the Appellant Company in this Case, under its present name but with a diminished share capital. The objects of the Company are defined, inter alia, in clause 3 (B) of the Memorandum of Association as "to manufacture, construct, repair, maintain, buy, sell, hire and let on hire, carriages, wagons, vehicles, engines and other rolling stock." The diminution of the share capital was carried out by reducing 29,851 fully paid shares of £10 each to shares of £7 each fully paid, and 16,250 shares of £10 each, on which £5 had been paid, to shares of £7 each with an unpaid liability of £3 10s.

The decline in the value of the wagons was due to a considerable decrease in the market value and the consequent impossibility of maintaining existing rentals as indicated by a speech made by the Chairman of the old Company at the extraordinary meeting of that Company held on 8th November, 1887.

8. The above-mentioned sum of £217,189 3s., representing the value of the wagons let on hire at 30th June, 1888, was included in the capital assets of the old Company in its Balance Sheet for the year ending 30th June, 1888, and had been built up as follows. Wagons built to be let on hire had been capitalised in a rough and ready manner at a price which would include a profit on the manufacture, and the capital value so arrived at had been included both in the yearly statement of the old Company's assets and as an item in the manufacturing account of the old Company, from which the profit shown in the revenue account of the old Company was arrived at, and upon which it

had paid Income Tax from year to year. Owing to the lapse of time and to the method of book-keeping adopted the amount of profit so included cannot now be ascertained. On the other hand the old Company wrote off year by year from the total sums so arrived at, representing the value of wagons let on hire, various amounts for depreciation, which amounts also were passed through the yearly revenue accounts of the old Company and so became a deduction in arriving at the profits of the year. We are unable to state the amounts so deducted.

9. The same system of book-keeping was continued after 1888 by the Company, and it was not till the year 1899 that the Company's accounts were kept in such a form that it was possible to ascertain exactly the cost of manufacturing wagons. Since that year wagons retained by the Company have been capitalised at a sum which includes what is termed a "manufacturing profit" and depreciation has continued to be written off by the Company year by year from the total value of the wagons. Depreciation on the wagons has also been allowed as a deduction in computing the profits of the Company for Income Tax purposes in each year.

10. Wagons have occasionally been purchased by the Company for the purpose of letting out on hire, and these wagons have generally been entered in the capital account at the cost price, but in some cases, where they were purchased very cheaply, they have been entered at a sum, being greater than the cost price, corresponding to the price at which similar wagons already stood in the Company's capital account, the difference being credited to the Company's revenue account upon which Income Tax has been paid.

11. In the year 1909, the wagons owned by the Company were re-valued by the Company, and a sum of £2,131 9s. 8d. was written off as the result of such re-valuation.

12. For the year ended 5th April, 1911, the question of the rate of depreciation to be allowed to the Company on wagons was considered at an appeal meeting by the Commissioners and was fixed by them at 5 per cent. on the written down value. Depreciation has since then been allowed to the Company at this rate for Income Tax purposes.

13. No claim was made at any time for relief from Income Tax for the amounts written off the value of the wagons in 1888 or 1909, these amounts being regarded by the Company as losses of capital.

14. During the ten years immediately preceding the appeal the Company ceased almost entirely to manufacture wagons to be let out on simple hire. Large numbers of wagons have,

however, been constructed to be let out on hire purchase agreements, by which agreements the so-called purchaser becomes entitled to purchase the wagons for a nominal sum on payment of a certain number of instalments which are called hire. Wagons so constructed were constructed under contracts made with the intending purchasers to their specifications. In some cases the tenants of wagons under hire purchase agreements have been unable to fulfil their contracts, and in such cases where it has not been possible to renew the contract in another form the wagons have come back into the possession of the Company and have been added to the wagons used by the Company for letting on hire. Some 437 wagons so came to be added to the wagons in the seven years ended 31st May, 1918.

15. The following statement No. 1 shews the number of simple hire wagons which were sold for cash or let on deferred purchase for the years ended June 30th, 1910, 1911 and 1912, and 31st May, 1913 to 1918.

The statement No. 2 shews how the said wagons were distributed into wagons on hire, idle wagons and scrapped wagons at the end of each year. The surpluses and deficiencies shown have been included in the Company's revenue accounts upon which Income Tax has been paid.

Simple Hire Wagons sold for cash or let on Deferred Purchase for the years ended 30th June, 1910, 1911 and 1912, and 31st May, 1913 to 1918.

## No. 1.

Year to	No. of Wagons.	Value in Books.	Sold for	Differences.	
				Surplus.	Deficiency.
June, 1910	7	278 7 5	256 10 8		21 16 9
	21	691 3 8	797 1 2	105 17 6	
" 1911	71	769 8 10	741 18 8		27 10 2
	23	836 6 9	945 19 8	109 12 11	
" 1912	1	10 7 6	8 0 0		2 7 6
	21	840 5 6	892 15 4	52 9 10	
May, 1913	64	589 12 8	477 0 0		112 12 8
	47	970 11 4	1,460 8 10	489 17 6	
" 1914	318	2,576 19 5	2,252 2 6		324 16 11
	2	17 7 1	19 0 0	1 12 11	
	47	2,331 0 4	2,868 9 10	537 9 6	
" 1915	62	3,447 15 7	3,283 5 8		164 9 11
	136	1,213 13 4	1,658 12 6	444 19 2	
	192	10,724 0 9	11,739 0 7	1,014 19 10	
" 1916	2	7 18 2	13 0 0	5 1 10	
	56	2,089 2 10	3,172 6 5	1,083 3 7	
" 1917	68	2,378 9 7	5,020 19 9	2,642 10 2	
* " 1918	461	10,114 1 3	23,000 0 0	12,885 18 9	
	20	690 13 4	1,384 5 9	693 12 5	
Total ...	1,619	£40,577 5 4	£59,990 17 4	£20,067 5 11	£653 13 11

\* See Note on next page.

The average annual total of the amounts realised by the sale of wagons in these nine years is 1.4 per cent. only of the whole amount subsequently realised by the sale of all the Company's wagons which had generally been used for letting on simple hire and is 1.5 per cent. only of the Company's average annual output for those years.

## No. 2.

Year to	No. of Wagons.	Value in Books.			Sold for			Differences.		
								Surplus.	Deficiency.	
<b>WAGONS ON HIRE.</b>										
* 1918	461	10,114	1	3	23,000	0	0	12,885	18	9
<b>IDLE WAGONS.</b>										
1910	28	969	11	1	1,053	11	10	105	17	6
1911	24	861	13	0	970	6	0	109	12	11
1912	21	840	5	6	892	15	4	52	9	10
1913	47	970	11	4	1,460	8	10	489	17	6
1914	47	2,331	0	4	2,868	9	10	537	9	6
1915	254	14,171	16	4	15,022	6	3	1,014	19	10
1916	56	2,089	2	10	3,172	6	5	1,083	3	7
1917	68	2,378	9	7	5,020	19	9	2,642	10	2
1918	20	690	13	4	1,384	5	9	693	12	5
	565	£25,303	3	4	£31,845	10	0	£6,729	13	3
								£187	6	7
<b>WAGONS SOLD AS SCRAP.</b>										
1911	70	744	2	7	717	12	4		26	10
1912	1	10	7	6	8	0	0		2	7
1913	64	589	12	8	477	0	0		112	12
1914	320	2,594	6	6	2,271	2	6	1	12	11
1915	136	1,213	13	4	1,658	12	6	444	19	2
1916	2	7	18	2	13	0	0	5	1	10
	593	£5,160	0	9	£5,145	7	4	£451	13	11
								£466	7	4

\* NOTE.—These 461 wagons are referred to in paragraph 19 of this Case.

16. In the seven years ended 31st May, 1918, 1,076 wagons were purchased by the Company, and of these 546 were sold and 530 let in those years. These purchases were necessary to replace wagons which had been let to tenants and which needed repair, and by reason of some of the wagons purchased being or becoming surplus wagons they were sold. The profits or losses on these transactions have been included in the Income Tax assessments upon the Company.

The number of wagons let on simple hire, which at 30th June, 1921, was 5,933, had fallen at 31st May, 1918, to 5,091. The following statement shews in a summarised form the whole of the transactions in wagons used for simple hire in the seven years. Evidence was given that if the Company desired to purchase wagons it was not always possible to acquire the exact number required without at the same time acquiring some additional wagons.

	1st July, 1911.	1st July, 1912.	1st June, 1913.	1st June, 1914.	1st June, 1915.	1st June, 1916.	1st June, 1917.	1st June, 1918.
No. of Wagons on Hire	5,933	5,972	5,792	5,717	5,655	5,644	5,566	5,091
„ Built during year	6	6	91	21	12	5	—	—
„ Purchased ...	130	31	279	28	5	5	2	2
„ Returned from Hire Purchase.	—	—	35	342	44	6	10	10
„ Sold as scrap ...	6,069	6,009	6,197	6,108	5,716	5,660	5,578	—
„ Sold ...	1	64	320	136	2	—	—	—
„ Broken up ...	21	47	47	254	56	68	481*	6
„	75	106	113	63	14	26	6	—
at	5,972	5,792	5,717	5,655	5,644	5,566	5,091	—
	30th June, 1912.	31st May, 1913.	31st May, 1914.	31st May, 1915.	31st May, 1916.	31st May, 1917.	31st May, 1918.	—

\* Includes the special transaction in 461 wagons already referred to.

17. The following statement shews the transactions of the Company for the same years in wagons let on deferred purchase agreements.

Number let on deferred purchase.		Number built in year.
1912	June 30 ... 6,556	940
1913	May 31 ... 5,782	221
1914	„ ... 5,616	482
1915	„ ... 5,701	793
1916	„ ... 4,311	669
1917	„ ... 3,644	—
1918	„ ... 3,192	—

18. The statement opposite shews the credit side of the revenue accounts of the Company for the years indicated.

The Company has always kept separate accounts in its books in respect of the letting out of wagons on simple hire, the profits from which are shewn separately opposite.

19. Wagon building was prohibited by the Government in the later years of the war, and the result of the war was to increase both the demand for wagons and the cost of manufacturing them. In the course of the year 1918 it therefore became possible for the Company to sell the wagons which it had let on hire at a price which became very profitable to itself, and thus to secure an immediate advantage which it would not have been possible to secure by waiting for opportunities for increasing the rents. Moreover, most of the wagons were let out under agreements for various terms of 10 years and under down to yearly agreements which were customarily continued from year to year. The position thus created had already been a cause of the sale of 461 wagons already referred to which took place in the spring of 1918. That sale was a sale to the tenants of the wagons before it had been finally decided to close down the business of letting wagons on hire. The profit upon it was included in the ordinary profit of the Company and dealt with in the usual way, and the Company had not claimed to be exempt from Income Tax in respect of it. The Company however contended at the appeal before us that it was not liable to pay such tax and it does not now admit that the surplus on such sale was properly chargeable with Income Tax.

No mention of this transaction is made in the report of the General Meeting of the Company held on the 31st July, 1918.

20. In the circumstances above set out Mr. J. Macgregor, the Managing Director of the Company, early in 1918 began to form the opinion that it was desirable for the Company which, as hereinafter to be stated, had then parted with its wagon-repairing business to dispose of its wagons let on hire and the benefit of any tenancy agreements connected therewith. The first steps directly toward this end were taken when early in the year 1919 letters were sent to the tenants of the Company's wagons offering

	30 June, 1912.	31 May, 1913.	31 May, 1914.	31 May, 1915.	31 May, 1916.	31 May, 1917.	31 May, 1918.
Gross Profit on Contracts ...	72,032 9 5	110,308 19 3	166,208 7 1	145,912 12 8	122,636 0 2	152,788 6 1	198,503 3 10
Wagon Rents Simple Hire	36,725 16 2	33,262 1 7	34,354 13 7	36,263 19 11	39,879 12 8	42,835 15 4	49,678 13 5
" Hire Purchase	12,657 3 0	10,476 2 3	11,485 8 10	12,235 10 11	12,544 11 8	8,619 10 6	6,496 17 3
Old Material	1,033 9 7	2,120 14 4	1,527 0 3	1,359 9 6	693 6 7	495 17 7	569 7 2
Discounts ...	4,886 2 5	5,411 15 8	6,548 17 7	4,302 15 5	5,312 3 2	7,467 3 5	2,553 12 6
Profit on re-sale of Wagons taken back from Hire Purchase and of Wagons let on Simple Hire	955 18 7	712 17 5	2,067 9 11	3,455 7 4	2,717 16 9	3,846 3 6	*13,905 19 5
Sundry Rents received	40 16 0	23 3 0	45 15 0	45 15 0	45 15 0	45 15 0	45 15 0
Interest	288 15 2	535 19 8	723 18 5	1,014 10 4	981 6 1	91 0 5	142 4 3
" on Investments	7,062 2 0	7,407 3 9	5,450 11 6	6,783 12 1	7,524 6 9	21,118 17 3	22,334 7 2
Wagon Repairs	839 15 1	7,232 14 9	9,331 1 5	4,868 17 9	10,694 17 10	26,642 7 3	32,434 7 3
Transfer Fees	35 5 0	26 7 6	35 2 6	17 0 0	17 10 0	44 2 6	65 17 6
Bank Interest	...	...	...	92 16 3	...	...	...
Profit & Loss Cr. Mainly balance of Association	2,195 16 3	...	...	...	...	25,831 6 0	42,521 15 5
Receipts & Payments	...	...	...	...	...	...	...
Profit on sale of Shares	...	...	...	...	...	...	...

\* Includes the 461 Wagons already mentioned.

them the right to purchase the wagons. As the result of these letters negotiations arose with the tenants and the Company, where it was unable to sell, attempted without great success to secure renewals of the tenancy agreements at enhanced rents. No definite decision to sell the wagons as a whole had yet been taken, nor had the question been discussed by the Board of Directors, nor was it referred to at the Annual General Meeting of the Company held to consider the accounts of the Company for the year ended 31st May, 1919. The report also of the meeting of the Company on 31st July, 1918, did not contain any reference to the matter. The number of wagons used by the Company for letting on hire sold in the year ended 31st May, 1919, was 55 at a profit of £939 7s. 3d. and the number of such wagons still on hand at that date was 5,085.

21. In the year 1919 the following circumstances arose to confirm the Managing Director's opinion as to selling the wagons let on simple hire and their tenancy agreements.

(1) The Company had possessed in various parts of the country branch repairing shops for repairing wagons made by the Company and used by its tenants. On 31st March, 1918, the Company had, as previously stated, sold these branch shops out and out to new Company, called Wagon Repairs, Limd., which was formed to undertake in any part of the country on a pooling basis the repairs for which the various manufacturers of wagons might be liable to their tenants. The charges of this Company for carrying out repairs became, in the Company's opinion, excessive, diminishing as they did to an undue extent the profit from letting wagons on simple hire for the cost of whose repair the Company was liable.

(2) The Company also contemplated extending its main business of manufacturing rolling stock, and large additional capital sums were required for this purpose.

22. In these circumstances the final decision was taken to sell the whole of the wagons used by the Company for letting out on simple hire and any tenancy agreements relating thereto. Whilst it is impossible to fix the exact date when this policy was adopted it is evidenced by the facts set out in the following three sub-heads.

(A) The policy was the policy of the Managing Director and was communicated by him to the other Directors and approved by them as shewn by the following extracts from their Minutes.

12th Jan., 1920.

In the course of his remarks the Managing Director informed the Board that he was adopting when possible the policy of selling the Company's stock of wagons on simple hire in preference to renewing the contracts.

12th July, 1920.

The Chairman laid before the Board the Balance Sheet . . . it was pointed out that there was a surplus of £146,929 2s. 3d. on the sale of a portion of the Company's capital account, viz. :—  
Wagons on hire . . . .

8th Nov., 1920.

With reference to the Minutes of the Board Meeting of the 12th January, 1920, the Managing Director stated that in disposing of the Company's wagons on simple hire he had deemed it advisable to dispose not only of the wagons but of the agreements for tenancy, and that these had been sold in different batches and that he had now completed the matter, thus having disposed of the whole of the Company's wagon hiring business. There would be a considerable surplus over the amount at which the assets stood in the Company's books, and that surplus would be used for the further development of the Company's capital accounts, which had already to some extent been anticipated, and which was the reason for the present considerable overdraft with the Company's bankers.

(B) All the wagons had in fact been sold by the end of the year before the 1st November, 1920, including idle wagons and wagons unfit for use.

(c) The wagons were sold not only to users of wagons but also to other traders who made a practice of letting out wagons on hire. Letters produced to us at the hearing of the appeal shewed that the Company referred persons applying to it for wagons to be let on hire to other traders—the Company itself no longer having wagons available to let out—and we were informed that the Company informed customers verbally that they had ceased to let wagons on hire.

23. The policy of selling the wagons and any tenancy agreements relating thereto had not been fully carried out at 31st May, 1920, when the Company's accounts for its trading year ended on that date had been made up, but considerable blocks of wagons, totalling 1,622, had already been sold resulting in a surplus of £148,651 10s. 9d. beyond the figures at which they were then valued in the books of the Company, and this surplus was credited in the revenue account of the Company. The Directors, however, charged the revenue account with £100,000 for " Reserve " in arriving at the profits of the year as disclosed in the accounts. The Chairman of the Company referred to the matter in the following terms as appears from the report of the Company's Annual General Meeting on 26th July, 1920.

" In moving the adoption of the report and statement of accounts, the Chairman said he would like, first of all, to refer to an unusual paragraph in the report, and that was that they had placed £100,000 to the Reserve Fund before submitting the matter to the shareholders. Their rule had been to shew

“ the disposable balance on profit and loss, and then to recommend, if they could, an amount to be placed to reserve. That £100,000 was part of the surplus of what they realised by the sale of a portion of the assets of the Company, viz., wagons let on hire, and the Directors thinking the amount properly belonged to the capital account of the Company rather more than to the revenue account, decided to place it straight away to the reserve. He hoped the shareholders would agree that what they did was right.”

“ Wagons let on simple hire (less depreciation) and on deferred purchase appeared in the Balance Sheet at £249,132, as compared with £242,067 in the previous year. That item required a little explanation. The Company had sold, in deferred purchase, a number of wagons which were let on hire previously, and of course until paid for they remained the property of the Company, and continued to be included in its assets.”

The Chairman's statement did not make any reference to any intention formed by the Directors of selling the remainder of the wagons.

24. Of the 1,622 wagons so sold by the Company :

800 were sold in April, 1920, to one firm of traders, who were letters out of wagons; these wagons, which were made up of various lots, were sold subject to the tenancies for varying periods of the persons who had hired them from the Company and the sale was as to 75 per cent. of the sale price upon the hire purchase system.

470 were sold to the existing tenants of the wagons, with the agreements for tenancy which ipso facto expired.

The remaining 352 wagons were made up of 42 idle wagons which were sold to the above-mentioned firm of traders, 156 idle wagons which were sold to the users of wagons and 154 scrap wagons which were sold as scrap.

The large proportion of wagons sold to persons who were letters out of wagons was due to the unwillingness of the users of wagons and of the principal tenants of the Company to purchase the wagons.

A statement was produced to us shewing in detail the particulars of the 1,622 wagons so disposed of, and shewing the periods for which the wagons in use had been let and the date of commencement of the letting.

25. Mr. J. H. Beach, the Secretary, and Mr. J. Macgregor, the Managing Director, were examined before us as to the course of the Company's trade and as to the intention of the Company in disposing of the wagons. They informed us that the gross estimated revenue of all the Company's wagons at the time of the sale was nearly £100,000 and that the net revenue after

meeting repairs would have been between £60,000 and £70,000. They admitted that the Auditors did not object to the profit on the sale of the wagons being included in the revenue account of the Company. They explained the grounds of policy as set out above for selling the wagons.

26. The following documents or copies thereof may be referred to for the purpose of this Case<sup>(1)</sup> :—

The original prospectus of the Company.

The Memorandum and Articles of Association of the old Company and the Company as from time to time amended.

The 1st, 2nd, 3rd, 4th, 5th, 6th, 7th and 29th Reports of the Directors of the Company.

Report of speech of Chairman at meeting of 8th November, 1887.

Report of meeting of 31st July, 1918.

„ „ „ 28th July, 1919.

„ „ „ 26th July, 1920.

The Directors' Report and accounts of the Company for the year ended 31st May, 1920.

Form of agreement used for letting wagons.

„ „ „ the hire purchase of wagons.

Statement giving in detail particulars of the 1,622 wagons disposed of.

27. In these circumstances it was contended on behalf of the Company that the sale of wagons and tenancy agreements referred to were sales of capital assets of the Company, and were not made in the course of any trade or business carried on by the Company.

28. The Inspector of Taxes on behalf of the Commissioners of Inland Revenue contended (inter alia) :—

(1) That the sum of profit realised from the sale of the wagons in question was a receipt of the trade or business of the Company (which was to manufacture and dispose of wagons and rolling stock) for the accounting period in question.

(2) That such receipt should be included in arriving at the profits of the Company assessable to Corporation Profits Tax.

(3) That the assessment was rightly made and should be confirmed.

29. We, the Commissioners who heard the appeal, after taking the matter into consideration gave our decision as follows :—

“ We have considered the facts and arguments submitted to us in this case.

(1) Omitted from the present print.

Very shortly the facts may be stated as follows :—

The Company manufactures wagons and rolling stock. In the past it has either disposed of the wagons by sale (outright or under hire purchase agreements) or made a profit out of them by letting them on hire. It decided for reasons explained to us to cease to let wagons on hire and to sell the wagons which were so let or available for letting. In accordance with such decision it has sold off the said wagons to wagon users and (as regards at any rate one large block of wagons) to traders who are themselves manufacturers and letters out of wagons. We are asked in effect to say that these sales of wagons were not made in the ordinary course of the trade of the Company, but were made with a view to getting rid of capital assets of the Company and we are asked to regard the whole of the transactions before us as of a capital nature and the "profit" on the sales as an accretion of capital.

We are unable to take this view. In our opinion we must have regard to the main object of the Company which is to make a profit in one way or another out of making wagons and rolling stock. We are unable to draw the very sharp line which we are asked to draw between wagons sold, wagons let on hire purchase and wagons let on simple hire, nor do we consider that this very sharp division in fact exists. We do not regard ourselves as precluded by the fact that as long as the wagons were let they were treated as "plant and machinery" subject to wear and tear, from deciding that they are stock in trade when they are sold, even though let under tenancy agreements, for they seem to us to have in fact the one or other aspect according as they are regarded from the point of view of the users or the Company. In our view, shortly, it makes no difference that one way of making a profit out of the wagons was given up, for the very giving up itself involved the making of a profit in another way out of the same wagons, and the purpose of the Company's trade is to make a profit out of wagons."

30. By the consent of both parties to the appeal the liability of the Company under this decision was agreed at £4,289 and we amended the assessments to that figure and determined the appeal accordingly.

Immediately upon our so determining the appeal, the Company expressed its dissatisfaction with our determination as being erroneous in point of law and in due course required us pursuant to the Finance Act, 1920, Section 56 (6), and the Income Tax Act, 1918, Section 149, to state a Case for the opinion of the High Court, which Case we have stated and do sign accordingly.

W. J. BRAITHWAITE, } Commissioners for the Special  
R. COKE, } Purposes of the Income Tax Acts.

York House,  
23 Kingsway,  
London, W.C.2.

19th July, 1922.

The case was argued before Rowlatt, *J.*, in the King's Bench Division on the 14th May, 1923, when Sir Duncan Kerly, *K.C.*, and Mr. A. M. Bremner appeared as Counsel for the Appellant Company, and the Attorney-General (Sir Douglas Hogg, *K.C.*) and Mr. R. P. Hills for the Crown.

Judgment was given on the following day in favour of the Crown, with costs.

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#### JUDGMENT.

**Rowlatt, J.**—In this case the only question is whether a sum of £148,000 ought to be included as a trade receipt of the Appellant Company for the purpose of computing its liability to Corporation Profits Tax. The Appellant Company and the Company that preceded it have since the year 1860 been engaged in the manufacture, sale and letting of railway wagons; both the Companies had power under their Memorandum to manufacture, let, buy and sell railway wagons, and the course of their business for the present purpose can, I think, be stated in quite a few words. They manufactured wagons, and they manufactured wagons to the specification of the customers who ordered them. In addition to that they made a certain number of wagons which they kept and let out at what is called simple hire. There was a third class, perhaps an intermediate class between the two, where they sold the wagons under a hire-purchase system, that is to say, in effect they were paid for by instalments. They also from time to time bought some wagons and resold them, and from time to time they sold wagons that they had been letting out; as they got old, or as they saw an opportunity, or if they found they had been obliged to buy rather more owing to the amount in which the wagons were offered for sale by other people, they sold the excess. Twice during their career, once when the company was changed and again later, it was discovered that the stock which they were carrying in the way of wagons, which they were letting out for hire, had depreciated more than had been allowed for in the accounts, and on each occasion that was written off as a capital loss. They had been allowed depreciation on wagons—wear and tear is the right phrase, I think—as plant, I suppose, under the Income Tax Acts; but subject to that they have always treated the proceeds of selling wagons as an item in their revenue account, although they now say they ought not to have done so. They have even paid Income Tax on that footing.

Now what has brought about the present controversy is this, that at the close of the War, and after the vicissitudes which had affected this business like a good many others during the War, it seemed obviously more advantageous from a business point of view that they should no longer let out wagons but should sell the wagons that they had and get rid of them. Now there

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comes the question as to whether the profit which they have made by selling those wagons, because they sold them advantageously at a higher price than they stood in their books, otherwise a higher price than they had hitherto taken for them in their accounts—whether that profit is an ordinary trade receipt.

On the part of the Appellant Company it is contended that really here you have two businesses, that they were a manufacturing company and that they were a company which provided themselves with wagons and let them out as a matter of business, and that that second business has in effect been wound up, and that it is a capital realisation; the wagons when they were put on the hire list were brought into the accounts at a price which allowed for a profit on the manufacture, as if it were a separate business to some extent in that way; but the business really has never been separated. It has all been one. It could, of course, easily have been separated if other machinery had been adopted—some subsidiary company, or something of that sort (there are many ways in which it could have been done)—in which that profit could have been made, or that branch of the business could have been constituted which bought wagons and let them out and sold them and made the wagons represent the capital which was being employed in the business, but that has not been done. The Company say it is a separate business and that, at any rate, this is a realisation of the plant of the business, even if it is not separate. On the other hand, it is said on behalf of the Commissioners of Inland Revenue that this is really only a phase of the general business. This Company is manufacturing these wagons and is selling them. It does not always sell them at once; it keeps them and hires them out, and now it is doing away with and selling those too, and you cannot separate it; it is all one, and this is simply a trade receipt. They have sold them all in a lump, as the Dublin distiller sold his whisky in *O'Kane's* case<sup>(1)</sup>, they sold them all at once in a rapid period and so got all their profits together instead of letting them out year by year and getting the profits annually and waiting until the wagons wore out, and so bringing their business to a conclusion in that way. In substance this is all just a business for the making and the ultimate selling of wagons.

Now I think the case is not so clear as either side represents it to be by any means, and the Commissioners have not recorded a finding in terms that this is a trade receipt. They have declined to divide the businesses and say that this is simply a profit of a company which was going to make profits out of wagons in some way or another: they obviously have taken a view of the facts which is contrary to the Appellants' contention, and I

(1) 12 T.C. 303.

(Rowlatt, J.)

certainly think that it would be impossible for me to differ from it. I think there is plenty of evidence in support of that way of looking at the case, and, that being so, I think the decision of the Commissioners must be affirmed and the appeal dismissed with costs.

An appeal having been entered against the decision in the King's Bench Division, the case was argued before the Court of Appeal (Pollock, *M.R.*, Warrington, *L.J.*, and Eve, *J.*) on the 19th, 20th and 21st February, 1924, when judgment was reserved.

Sir John Simon, K.C., Sir Leslie Scott, K.C., and Mr. A. M. Bremner appeared as Counsel for the Appellant Company, and Sir Douglas Hogg, K.C., and Mr. R. P. Hills appeared for the Crown.

On the 7th March, 1924, judgment was given in favour of the Crown, with costs (Pollock, *M.R.*, dissenting).

#### JUDGMENT.

**Pollock, M.R.**—This is an appeal from a judgment of Mr. Justice Rowlatt dated 15th May, 1923, upon a Case stated by the Commissioners for the Special Purposes of the Income Tax Acts, under the Finance Act, 1920, Section 56, Sub-section (6), and the Income Tax Act, 1918, Section 149, for the opinion of the High Court.

The question to be decided arises in respect of an assessment to Corporation Profits Tax made upon the Appellants in the sum of £4,321 15s. 0d., for the accounting period from 1st January, 1920, to 31st May, 1920, by the Commissioners of Inland Revenue under the Finance Act, 1920, Part V—the part which charges the Corporation Profits Tax—in respect of the profits of its business.

By Section 53 of the Finance Act, 1920, the profits subjected to the tax are to be taken to be the actual profits arising in the accounting period, and, subject to provisions which are not relevant to the question to be decided, “ shall be the profits and gains determined on the same principles as those on which the profits and gains of a trade would be determined for the purposes of Schedule D set out in the First Schedule to the Income Tax Act, 1918, as amended by any subsequent enactment.”

The question at issue is whether a sum of £148,651 10s. 9d., the surplus which resulted from the sale by the Appellants of certain blocks of wagons totalling 1,622 in number, beyond the figures at which they were then valued in the books of the Company, should be included as a trade receipt of the Company for the purposes of computing its liability to Corporation Profits Tax for the accounting period in question, which ended on 31st May, 1920.

(Pollock, M.R.)

The relevant charging words of the Income Tax Act, 1918, are to be found in Schedule D, 1 (a), and are as follows: "Tax shall be charged in respect of the annual profits or gains arising or accruing to any person residing in the United Kingdom from any trade in the United Kingdom."

The Commissioners who heard the case, as it was their province to do, have found the facts and reached conclusions of fact, and reasoning upon them have felt themselves unable to take the view presented to them on behalf of the Appellants, and therefore decided in favour of the Crown. Their decision was affirmed by Mr. Justice Rowlatt; hence this appeal.

The facts are stated in the Special Case, from which it appears that the Company in their present form have been carrying on for many years the business of constructing wagons and selling them outright, or upon a deferred purchase or hire purchase system. They have also as a part of their business let out wagons to tenants on simple hire. The number that they had in hand for this latter purpose, in the year ending on 31st May, 1919, was 5,085. All these trucks were subsequently disposed of in the months of May and June, 1920. The proceeds of 1,622 wagons—part of the 5,085—were received during the accounting period and so fall to be considered in the present case, and the sum received from the sale of this number by way of surplus to the Company is the before-mentioned sum of £148,651 10s. 9d.

It is claimed by the Crown that this sum was a part of the annual profits or gains accruing to the Company in the accounting period and is therefore subject to tax, that it is impossible to separate the profits obtained by the Company whether by the construction and sale outright of wagons, or by the slower method of sale involved in deferred purchase or hire purchase systems, or by the letting out of wagons, that it was all business undertaken by, and within the powers of, the Company and so not severable.

It was further argued that in any case the question raised was one of fact, so that the decision of the Commissioners was not open to review. Upon this latter point the Crown relied upon the well-known case of the *American Thread Co. v. Joyce*, 6 T.C. 1, where Mr. Justice Hamilton reviewed the authorities and stated the limits of the province of the Commissioners and the function of the Court before which the case comes on appeal. His decision was accepted by the Court of Appeal and the House of Lords, 6 T.C. 163. It is clear from this case that upon a question of fact and a conclusion of fact, the decision of the Commissioners cannot be questioned, if there was evidence to justify the Commissioners' findings. It is equally clear from a number of cases, and particularly the recent case of *The Great Western Railway Co. v. Bater*<sup>(1)</sup>, [1922] 2 A.C. 1, that no unassailability can be

(1) 8 T.C. 231.

**(Pollock, M.R.)**

secured for a finding of the Commissioners on a mixed question of law and fact. That belongs, and belongs only, to a finding on a question of pure fact. (See per Lords Atkinson and Carson in the above case at pages 12 and 35<sup>(1)</sup>.)

In my judgment the Commissioners have not decided the question before them as one of fact, nor upon the conclusions of fact within their province. The last paragraph of clause 29 of the Case makes this, in my opinion, clear. That paragraph gives their reasoning. They base their decision not simply upon the facts, which they say do not afford a sharp outline, but upon the nature of the business carried on by the Appellants, as they construe the purpose and trade of the Company by the interpretation of the documents and materials before them. They hold that to the wagons which were the subject of the sale producing the surplus of £148,651 10s. 9d., the character either of plant and machinery, or of stock in trade, may be attached according as they are regarded from the point of view of the users of the wagons or of the Company, and finally give their preference to the view that the wagons should be treated as stock in trade for the purpose of the assessment.

In my judgment, therefore, the decision of the Commissioners is open to review, and must be considered as a question of law in the light afforded by the facts found and the documents and materials referred to and attached to the Case.

It becomes necessary to recapitulate certain features of the business carried on by the Appellants, and incidents that have occurred. The business of letting out wagons for hire is well known as an independent business of itself; and indeed as stated in paragraph 24 of the Case the wagons in question were sold to "letters out of wagons," for the reason that the users of the wagons, and the principal tenants of the Appellants, were unwilling to become purchasers and preferred to do business as hirers from those who as "letters" acquired the wagons from the Appellants.

Not to go further back in the history of the Company than 1899, wagons have been from time to time not only made by the Company, but purchased for the purpose of letting out on hire, and these wagons so purchased have been entered in the capital account. In 1909 the wagons owned by the Company were re-valued and a sum of over £2,000 was written off as a result of the re-valuation. No claim has been made at any time for relief from Income Tax for the amount written off the capital value of the wagons, this amount being treated by the Company as loss of capital.

Between 1911 and 1918 the number of the wagons let on simple hire fell from 5,933 to 5,091, and tables in the Case show the actual numbers let out during the succession of years. The

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(1) 8 T.C. at pp. 244 and 257.

**(Pollock, M.R.)**

Company has always kept separate accounts in its books in respect of the letting out of wagons on simple hire. Those profits are set out in the table attached to the Case and show that the revenue received from letting out the trucks on the 31st May, 1918, was the sum of £49,678 13s. 5d.

This revenue appears to have increased down to the time when the trucks were sold. In the year 1919 the Company determined to give up the branch repairing shops for repairing wagons, which they had possessed in various parts of the country, as that department of their business, ancillary to the letting out of wagons, had become too costly to be profitable. They also contemplated extending their business of manufacturing rolling stock, for which it was necessary to find large additional capital. In these circumstances, the final decision was taken to sell the whole of the wagons used by the Company for letting out on simple hire, together with any tenancy agreements relating thereto.

This policy was carried into effect by the sale of the total number of 5,085 wagons, together with their tenancy agreements, in the course of the months of May and June, 1920.

This sale was referred to by the Chairman at the Company's Annual General Meeting held on 26th July, 1920, as a matter of importance, and as a sale of a portion of the assets of the Company—namely, the wagons let on hire.

Eight hundred of the 1,622 trucks which produced the surplus now in question were sold to one firm of traders who were letters out of wagons.

The practice of keeping the accounts for letting out the wagons on simple hire separate from the other activities of the Company, the sale of so large a number as over 5,000 wagons in the course of two months, in addition to the other features which I have recapitulated, appear to me to differentiate the transaction in question from the ordinary business of the sale of trucks, whether outright or on the deferred purchase system.

It is a clear principle of Income Tax law that the substance of the matter is to be regarded. The claim of the Crown cannot be defeated by any ingenious device of book-keeping, nor is it right that a subject should lose his immunity from a tax by imperfect book-keeping methods, confusing capital and income.

Lord Halsbury in the *Secretary of State for India v. Scoble*<sup>(1)</sup>, [1903] A.C. 299, so dealt with the question which had there to be considered as to whether "an annuity" of one undivided share, representing partly purchase money and partly interest on unpaid balance, was to be treated as capital or income. Lord Halsbury on page 302 said<sup>(2)</sup>: "Looking at the whole nature

(1) 4 T.C. 618.

(2) *Ibid.* at p. 624.

(Pollock, M.R.)

“ and substance of the transactions (and it is agreed on all sides that we must look at the nature of the transaction and not be bound by the mere use of the words) this is not the case of a purchase of an annuity.” (See also *J. & M. Craig, Ltd. v. Commissioners of Inland Revenue*, 1914 S.C. 338.)

What is the substance of the matter in the present case? One test occurs to my mind which it may be fair to apply. Why did the Appellants carry so large a stock of wagons, far beyond the number needed for their selling business? The answer upon the facts appears plain, that it was for the purpose of carrying on the business of “ letters out of wagons.”

If they go out of the business of letting wagons, the stock can be realised, and so realised in order that the capital arising therefrom could be set free and devoted to the increased business of manufacturing rolling stock, for which new capital was required. They have disposed of the capital which brought them in revenue of about £50,000 a year.

Mr. Justice Rowlatt felt that the case was not so clear as it was represented to be on either side, and noted that the Commissioners have not recorded a finding in terms that this £148,651 10s. 9d. is a trade receipt.

I find it impossible to treat this sum as part of the annual profits or gains of the Company, nor can I accept the view of the Commissioners stated at the end of the paragraph 29 of the Case, that “ it makes no difference that one way of making a profit out of the wagons was given up, for the very giving up itself involved the making of a profit in another way out of the same wagons, and the purpose of the Company’s trade is to make a profit out of wagons.” To my mind this sum arose from a sale and profit derived from accumulated plant, and the sale of plant is the sale of a capital asset. The profit was not earned in carrying on the business of letting wagons but in closing it down. To use the familiar metaphor, they have cut down the tree, and not merely gathered the fruit of it.

For all these reasons, in my judgment the Crown have failed to show (and the onus is on them) that this money was a part of the annual profits or gains arising from the trade of the Company. In my judgment, therefore, the appeal should be allowed.

I need hardly add that as I am differing from Mr. Justice Rowlatt and from my two learned colleagues, I do so with reluctance, but at the same time my opinion is clear.

**Warrington, L.J.**—This is an appeal from a judgment of Mr. Justice Rowlatt on a Special Case stated by the Commissioners in reference to an assessment by them of the Appellants to Corporation Profits Tax for the accounting period from the 1st January, 1920, to the 31st May, 1920. The learned Judge upheld the assessment.

**(Warrington, L.J.)**

The question raised by the Special Case is whether a sum of £148,651 10s. 9d. ought to be included as a trade receipt of the Appellants for the purpose of computing their liability to Corporation Profits Tax for the period in question. The sum above mentioned is the amount by which the proceeds of sale of 1,622 wagons sold by the Appellants during the accounting period exceeded the sum entered in the Appellants' books as the value of such wagons.

The Corporation Profits Tax was imposed by Section 52 of the Finance Act, 1920, on the actual profits of a company arising in the accounting period, and such profits are to be the profits and gains determined on the same principles as those on which the profits and gains of a trade would be determined for the purposes of Schedule D to the Income Tax Act, 1918, with certain modifications not material to the present case.

Income Tax under Schedule D is charged in respect of the annual profits or gains arising or accruing from any trade, profession, employment or vocation. The question, therefore, is whether the sum in question is an annual profit arising or accruing to the Appellants from their trade.

The main contention on the part of the Appellants was that they carried on two distinct trades or businesses, one concerned with the manufacture and sale of wagons, the other with the manufacture of wagons for the sole purposes of letting them on hire and making profits from their earnings, and that the wagons in question formed part of the stock of wagons used as capital for the purposes of the latter trade or business and were sold not in the course of such trade or business but for the purpose of winding it up and finally discontinuing it, and that the profit made by such sale ought to be treated as an accretion to capital and not as a profit to be taken into account for the purpose of computing profits assessable to tax.

The crucial question, as it seems to me, is a question of fact—Did the Appellants carry on a separate trade or business concerned exclusively with the letting on hire of wagons appropriated by them to that purpose, or was the letting of the wagons merely one means of earning profits in the business carried on by them? The Commissioners have, in my opinion, answered this question adversely to the Appellants, as I will point out presently, and we have, therefore, first to determine whether the answer to the question involves any conclusion of law, and if not, then we are bound by the finding of the Commissioners unless we can say either that they have misdirected themselves on a point of law or that there was no evidence on which they could reasonably come to their conclusion of fact.

For my own part, I cannot see that the question whether a man carries on one business or two separate businesses is anything but a mere question of fact, nor can I see that in dealing with

(Warrington, L.J.)

that question there is any room for a misdirection in point of law, for in my opinion no preliminary question of law arose. If this view is correct we are bound by the Commissioners' finding if there was any evidence to support it.

Whether on this finding of fact and on the other facts stated in the Case the profit in question ought to be included in the amount of profits for the purposes of the Act imposing the charge, seems to me to be a question of law on the construction of the Statute, and on this it would be competent to the Court to review the ultimate decision if it thought it wrong. I may, however, say at once that if the facts are as I think the Commissioners have found them, I can find no ground in law for interfering with their ultimate decision. I turn now to the Special Case in order to ascertain what are the material facts found and whether there was evidence to support those findings.

The Appellant Company, which is the successor of a previous company called The Gloucester Wagon Company, Limited, established in 1860, was incorporated in the year 1888. Its main objects were to acquire and carry on the business of the old company and "to manufacture, construct, repair, maintain, buy, sell, hire and let on hire, carriages, wagons, vehicles, engines and other rolling stock for use on railways, tramways and common roads."

Both the old Company and the Appellant Company constructed wagons to be let on hire (called in the Case "simple hire") and also constructed wagons for sale in some cases for cash but generally on what is known as the hire purchase system.

No real distinction was made in the accounts of the Appellant Company between the wagons constructed for sale and those constructed for and let on hire except that for ascertaining the manufacturing costs of the latter class of wagons there has been added to actual costs something for "manufacturing profit." It is enough to say that the value of such wagons where ascertained and subject to depreciation has been brought into the accounts of the Company for revenue purposes whether for division of profit or for computing Income Tax.

A few wagons have been purchased for the purpose of letting on hire and these have been brought into the accounts either at cost or, where purchased very cheaply, at a higher sum.

From time to time wagons kept for letting on hire have been sold and the results of such sales have been included in the revenue accounts on the footing of which Income Tax has been paid. In the year 1918, for reasons explained in paragraph 19 of the Case, 461 of such wagons were sold at a considerable profit, and the result of such sale was brought into the accounts for Income Tax purposes.

The sale of the 1,622 wagons in question with the benefit of the current tenancy agreements affecting such of them as were out on hire was made in pursuance of a policy adopted by the

**(Warrington, L.J.)**

management of ceasing to let wagons on simple hire and confining the activities of the Company to manufacturing and selling wagons and so forth either by way of hire purchase or for cash.

It seems to have been the intention of the Board not to divide as dividend the surplus arising from the sale in question, but to use it "for the further development of the Company's "capital accounts." This may be so, but the Company by so dealing with the money would not make it any the less an item to be brought into account for Income Tax purposes, if it was in fact a profit arising or accruing from their trade.

The whole of the wagons used for letting on hire were sold before the 1st November, 1920.

Their findings of fact are thus stated by the Commissioners: "The Company manufactures wagons and rolling stock. In the past it has either disposed of the wagons by sale (outright or under hire purchase agreements) or made a profit out of them by letting them on hire." Then, after stating the facts as to the sale of the wagons in question substantially as above-mentioned and alluding to the contentions of the Company, they proceed to give some reasons for their inability to accept the argument on the part of the Company, and conclude as follows: "In our view, shortly, it makes no difference that one way of making a profit out of the wagons was given up, for the very giving up itself involved the making of a profit in another way out of the same wagons and the purpose of the Company's trade is to make a profit out of wagons."

There is here in my judgment a clear finding of fact that the Company carried on one trade only, that of manufacturing and dealing with wagons for the purposes of profit, and that selling and letting the wagons were nothing but two modes of earning profits in the one trade. In my opinion, there was ample evidence to support such a finding and, though it is immaterial to say so, I think I should have come to the same conclusion.

On this finding the final decision that the profits in question were profits arising or accruing in the trade, and therefore assessable to tax, seems to me to be inevitable. If the Company makes a profit by the sale of wagons manufactured by or purchased by them, they are thereby making a profit out of their business, which is, shortly, to manufacture and deal in wagons, and it cannot, in my opinion, matter that by means of the particular wagons they previously earned their profits in another way.

Cases were cited on both sides in which certain profits were or were not held to be so arising or accruing on the facts of the particular case, but they seem to me to afford little assistance. At all events, none of them lays down any principle with which the view I have expressed is not in accord.

On the whole, I think the appeal fails, and must be dismissed with costs.

**Eve, J.**—The question raised on this appeal is whether a sum of £148,651 10s. 9d., surplus proceeds of sale of certain railway wagons over the value put upon them in the books of the Appellant Company, ought, for the purposes of computing the Company's liability to Corporation Profits Tax, to be treated as profits arising from the business of the Company or as an untaxable accretion to capital.

The Commissioners have held the sum to be taxable profits and not a capital accretion, and their conclusion has been affirmed in the Court below.

In my opinion, notwithstanding the language in which it is expressed and the criticism to which it has given rise, the finding of the Commissioners is a finding of fact, in support of which there was certainly evidence, and which, therefore, cannot be reviewed by us. I think the language of paragraph 29 of the Case shows conclusively that the question the Commissioners put to themselves was: "Were these wagons sold in the ordinary course of trade or were they realised in the winding up of a severable part of the Company's business?" and in the words "We are unable to take this view," they negative the latter alternative. It is true this finding is followed by some further observations, but these do not, in my opinion, alter or modify the finding—at most they indicate the views of the Commissioners on some of the points debated before them.

This conclusion, if correct, would dispose of the appeal, but, assuming that the answer to the question propounded by the Commissioners is properly to be regarded as in part an inference of law to be drawn from the facts, it then becomes necessary to consider the relevant facts and the true inference to be drawn from them.

The Company was incorporated in September, 1888, to take over the assets and liabilities of a pre-existing Company, known as the Gloucester Wagon Company, Limited, and to continue with a reduced capitalisation the business of the vendor Company. The nature of that business and of the business consistently carried on by the Appellant Company since its incorporation is adequately stated in paragraph (b) of Clause 3 of the Appellant Company's Memorandum of Association, in these terms: "To manufacture, construct, repair, maintain, buy, sell, hire and let on hire, carriages, wagons, vehicles, engines and other rolling stock for use on railways, tramways and common roads." At the date of the sale the vendor Company had some 3,232 wagons let out on hire purchase agreements and 5,436 let on simple hire. (See Exhibit No. 11, page 33.) The purchasing Company continued business on exactly the same lines; it manufactured wagons, sold those for which purchasers could be found for sums payable either in cash down or by instalments spread over different periods, and let others on hire at rentals which secured an adequate return on the cost of manufacture, plus the ordinary profit thereon, and, in addition, a sufficient margin to cover the estimated cost of keeping the wagon in repair. When

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the demands of wagon hirers exceeded the available supply of wagons manufactured by the Company, wagons of other manufacturers were purchased and let at rentals based on cost price, or, if this happened to be less than the estimated value, then on the increased value, plus in all cases a provision for the cost of repairs. Wagons withdrawn from hire, either from want of demand or because they had become unserviceable, were sold in the ordinary course of business, as were also wagons sold or contracted to be sold to purchasers on the hire purchase system who failed to complete the instalments.

As will be seen from the table at page 11 of the Case, the rentals derived from the letting out of the wagons were of a progressive amount during the period there dealt with. In the year ending in June, 1912, they amounted to £36,725, in 1918 this figure had increased to £49,678, but in the meantime the cost of wagon repairs had advanced with much greater rapidity. In 1912 it was £839, in 1918, £32,434; the average for the four years, 1913, 1914, 1915 and 1916 was £8,015, that for the two years, 1917 and 1918, £29,538. These conditions and the increased opportunities for disposing of wagons by sale at largely enhanced prices, due to the shortage occasioned by the suspension of manufacture during the war, led the Company to the conclusion that it would be more profitable to discontinue the letting of wagons on hire, and to sell those already let as the hiring agreements determined, or in some cases, subject to the unexpired residue of the hirer's term.

Pursuant to this policy 1,622 wagons were sold in the year ending the 31st May, 1920, at prices which showed a surplus of £148,651 10s. 9d. over the figures at which they were valued in the books of the Company, and since that date the whole of the remaining wagons let on hire have been disposed of.

Is the surplus arising from these transactions profit arising from the business of the Company?

What is the business of the Company? The manufacture of and trading in wagons. The attempt to raise an analogy between the business of this Company and that of a job master or threshing machine proprietor involves, in my opinion, a misreading of the primary object of the Company as declared in the Memorandum of Association. It is primarily a manufacturing company, the output of the factory constitutes the stock in trade, and the realisation of that output the source from which profit on the capital invested in the purchase of the business and of the factory, plant and machinery is to be looked for. It is more akin to the business of a coachbuilder than to that of a job-master. The particular manner in which the manufactured stock is dealt with whether by sale out and out or on a deferred payment system, or whether by retention so long as it can be retained at a profit, and by sale, when it can no longer be so

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retained, cannot, in my opinion, alter the true character of the Company's business. It manufactures and trades in wagons, and the methods from time to time adopted of dealing with the manufactured products are matters of domestic policy and cannot be regarded as converting stock retained for letting on hire into plant or as establishing a separate business distinct and apart from the ordinary business of the Company.

The combination of circumstances brought about by the enhanced value of the wagons and the increased cost of their maintenance has induced a drastic and more or less sudden change of policy, resulting in the immediate realisation of a large block of stock at a big profit; but I am unable to see any sufficient ground for treating this otherwise than as profit arising from the business. Its exceptional magnitude is solely due to the drastic and complete change of policy and the concurrent appreciation in the value of the stock.

I think the appeal fails.

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An appeal having been entered against the decision in the Court of Appeal, the case was argued before the House of Lords (Viscount Cave, *L.C.*, and Lords Dunedin, Atkinson, Sumner and Buckmaster) on the 29th and 30th January, 1925, when judgment was reserved.

Sir Leslie Scott, K.C., Mr. Clauson, K.C., and Mr. A. M. Bremner appeared as Counsel for the Appellant Company, and the Attorney-General (Sir Douglas Hogg, K.C.) and Mr. R. P. Hills for the Crown.

On the 19th February, 1925, judgment was given unanimously in favour of the Crown, with costs.

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JUDGMENT.

**Viscount Cave, L.C.**—My Lords, I have had the advantage of reading the opinion about to be delivered by my noble and learned friend, Lord Dunedin, and I agree with his reasoning and his conclusion.

**Lord Dunedin.**—My Lords, this is an appeal against an assessment for Corporation Profits Tax confirmed by the Commissioners, whose opinion has upon a Case Stated been confirmed by Mr. Justice Rowlatt and the Court of Appeal.

The Appellants are a company which dealt in wagons. It acquired wagons generally by construction in its own works, but also on many occasions by purchase. The wagons so acquired it dealt with in two ways. Either it sold—whether for cash down or on a deferred payment system matters not—or it hired them out. The hired wagons remained the property of the company, and when the hiring was over the wagon was either worn out or was sold. The hiring accounts were kept separate, but it was all one business. In the case of the wagons used in

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the hiring business which had been made in the workshops, the method of bookkeeping employed was to charge the wagon so used as if it had been sold to the hiring business at a price including a calculated sum added as profit on manufacture. Year by year as the hiring went on the sum so charged was written down in respect of depreciation.

The Appellants, finding that after the war (during the continuance of which wagon making had been prohibited) there was a great scarcity of wagons, came to the conclusion that it would be more profitable to sell all the wagons which they were using for hiring; and in the result they received sums larger than the sums at which the wagons written down as aforesaid stood in the books. It is these sums on which as profit Corporation Profits Tax has been charged.

Now as regards the original profit when the wagon was entered with a calculated sum added to its cost on it, tax would automatically be charged in the year's accounts, as it would enter in the revenue account as kept as profit on work done. But when in the long run on a sale a wagon which had been charged at a fictitious price—for it being all one business no money really passed—realised more than that price as it stood after depreciation had been subtracted, then I think it is evident that the sum, being the difference between the sum realised and the sum as entered, minus depreciation, is just extra profit on which so far no tax has been levied.

The Appellants argue that this is really a capital increment; and to say so they call these wagons plant of the hiring business. I am of opinion that in calling them plant they really beg the whole question. The Commissioners have found—and I think it is the fact—that there was here one business. A wagon is none the less sold as an incident of the business of buying and selling because in the meantime before sold it has been utilised by being hired out. There is no similarity whatever between these wagons and plant in the proper sense, e.g., machinery, or between them and investments, the sale of which plant or investments at a price greater than that at which they had been acquired would be a capital increment and not an item of income. I think that the appeal fails.

**Lord Atkinson.**—My Lords, I concur.

**Lord Sumner.**—My Lords, I concur.

**Lord Buckmaster.**—My Lords, I concur.

*Questions put:*

That the Order appealed from be reversed.

*The Not Contents have it.*

That the Order appealed from be affirmed and this Appeal dismissed with costs.

*The Contents have it.*