No. 1295—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—13TH AND 14TH MAY, 1942

COURT OF APPEAL—8TH, 9TH AND 10TH FEBRUARY, AND 12TH MARCH, 1943

HOUSE OF LORDS—7TH, 8TH, 9TH, 10TH AND 14TH FEBRUARY, AND 19TH MAY, 1944

F.P.H. FINANCE TRUST, LTD. (IN LIQUIDATION) v. COMMISSIONERS OF INLAND REVENUE (No. 1) [1]

Sur-tax—Undistributed income of companies—Investment companies—"the income whereof consists mainly of investment income"—Financial company making trading losses greater than its investment income—Whether an investment company—Finance Act, 1922 (12 & 13 *Geo.* V, *c.* 17), *Section* 21; *Finance Act*, 1936 (26 *Geo.* V & 1 *Edw.* VIII, *c.* 34), *Section* 20.

The Appellant Company had been assessed for a number of years under Case I *of Schedule D in respect of its general financial business which consisted mainly of dealing in stocks and shares. During the calendar years* 1933 *to* 1936 *the profits from this business greatly exceeded the Company's income from investments, but during the succeeding fifteen months ended* 31*st March*, 1938, *the Company's trading losses were much larger than its investment income, which was its sole income in that period. On* 1*st April*, 1938, *the Company passed a resolution for voluntary winding up.*

A direction was issued by the assessing Commissioners under Section 21, *Finance Act*, 1922, *as extended by Section* 20, *Finance Act*, 1936, *in respect of the Company's income for* 1938–39, *on the ground that, since at the date of liquidation and for the previous fifteen months the Company's income was derived solely from investments, it was a company "the income whereof "consists mainly of investment income" and that it was thus an investment company to which Section* 20 (6) *applied for that year. On appeal, the Special Commissioners confirmed the direction.*

Held (*Lord Russell of Killowen dissenting*), *that the Company was not at the material time an investment company within the meaning of Section* 20 (1) *of the Finance Act*, 1936.

CASE

Stated under the Finance Act, 1927, Section 42 (7), and Income Tax Act, 1918, Section 149, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 22nd July, 1940, F.P.H. Finance Trust, Ltd. (in liquidation) (hereinafter called "the Appellant Company") appealed against a direction made upon it for the year of assessment 1938–39 under the provisions of Section 21 of the Finance Act, 1922, as extended by the provisions of Section 20 of the Finance Act, 1936.

2. The direction was made on the footing that the Appellant Company was at the date of liquidation an investment company to which the provisions of Section 20 (6) of the Finance Act, 1936, were applicable, and the sole question for our decision was whether the Appellant Company was such a company.

[1] Reported (K.B.) 167 L.T. 288; (C.A.) [1943] K.B. 345; (H.L.) [1944] A.C.285.

3. The Appellant Company was incorporated on 13th September, 1912, under the style of the Rhoex Development Co., Ltd., as a finance company, having among its expressed objects, *inter alia*, the dealing in shares and investments.

A copy of the memorandum of association is annexed hereto, marked "A", and forms part of this Case(1).

4. For some years the Appellant Company, which on 21st April, 1927, changed its name to F.P.H. Finance Trust, Ltd., carried on a general financial business including underwriting and dealing in options. The main business of the Appellant Company, however, was that of dealing in stocks and shares, and it was assessed to Income Tax under Case I of Schedule D of the Income Tax Acts in respect of the profits of that business. A copy of a statement shewing the statutory profits and losses for periods from 1st April, 1930, to 1st April, 1938, marked " B ", and copies of the balance sheets and accounts for the year ended 31st December, 1937, and the three months ended 31st March, 1938, marked " C " and " D " respectively, are annexed hereto and form part of this Case(1).

5. On 1st April, 1938, the Company passed a resolution for voluntary winding up.

6. For the year ended 31st December, 1937, the Appellant Company sustained a trading loss of £412,464 (computed according to the Rules of Case I of Schedule D) and for the three months ended 31st March, 1938, a further trading loss of £72,202 (similarly computed). In these periods the Company received interest and dividends taxed by deduction amounting to £82,145 and £11,668, respectively. For the year 1937–38, ended 5th April, 1938, the Company claimed relief under Section 34 of the Income Tax Act, 1918, by reference to the trading loss it had sustained in that year. The claim was allowed. A copy of a letter from the Inspector of Taxes, dated 23rd September, 1939, with the enclosures thereto setting out the Inspector's computations of the amount repayable to the Company is annexed hereto, marked " E ", and forms part of this Case(1).

7. Evidence, which we accepted, was given to the effect that the Appellant Company continued down to the date on which it passed the said resolution for winding up to carry on the business of dealing in shares.

The following statements of figures showing the volume of this business in the two periods immediately preceding the commencement of liquidation, viz. :—

(i) a copy of the Company's share dealings accounts for the year to 31st December, 1937, and for the period to 1st April, 1938, and

(ii) a summary of the Company's stock exchange transactions during the period from January, 1938, to the date of commencement of liquidation,

are annexed hereto, marked " F " and " G " respectively, and form part of this Case(1).

8. It was contended on behalf of the Appellant Company that at the date of the passing of its resolution for winding up the Company was not an investment company within the meaning of Section 20 of the Finance Act, 1936, and accordingly that it was not within the powers of the Special Commissioners to make the said directions either under the provisions of Sub-section (6) of the said Section 20 or otherwise.

(1) Not included in the present print.

9. For the Respondents it was contended that on the evidence the Appellant Company was at the date of liquidation, and had been for a period of 15 months prior to 1st April, 1938, deriving income solely from investments. These facts were sufficient to bring it within Section 20 for the year 1938–39.

10. We, the Commissioners who heard the appeal, accepted the contention of the Respondents and confirmed the direction.

11. The Appellant Company immediately after the determination of the appeal declared to us its dissatisfaction therewith as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Finance Act, 1927, Section 42 (7), and Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

C. C. GALLAGHER,
G. R. HAMILTON,
} Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94/99 High Holborn,
London, W.C.1.

28th October, 1941.

The case came before Macnaghten, J., in the King's Bench Division on 13th and 14th May, 1942, and on the latter date judgment was given in favour of the Crown, with costs.

Mr. J. Millard Tucker, K.C., and Mr. F. Heyworth Talbot appeared as Counsel for the Appellant Company, and the Solicitor-General (Sir David Maxwell Fyfe, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Macnaghten, J.—This is an appeal against a direction made upon the Appellant Company for the year of assessment 1938–39, under the provisions of Section 21 of the Finance Act, 1922, as extended by the provisions of Section 20 of the Finance Act, 1936; and it raises a short and interesting point. On 1st April, 1938, the Appellant Company passed a resolution for winding up. The question at issue is whether, at that date, it was an " investment " company " within the meaning of Section 20 of the Finance Act, 1936, and that depends on whether its income consisted mainly of " investment " income ". If it was an " investment company " within the meaning of that Section at the date of the commencement of the winding up, then pursuant to Sub-section (6) the actual income of the Company from all sources since that date is deemed to be the income of the members for purposes of Sur-tax.

The Appellant Company was incorporated on 13th September, 1912. For a number of years it carried on a general financial business including underwriting and dealing in options; but its main business was that of dealing in stocks and shares. It was throughout assessed to Income Tax under Case I of Schedule D of the Income Tax Act, 1918, in respect of the profits of its business. From a statement exhibited to the Case it appears that during the years 1933 to 1936 the profits of its business were very much larger than its income from investments; but in the year 1937 there was a trading loss of £412,464 and in the first three months of 1938 a trading loss of £72,202. The trading losses in the last fifteen months before the liquidation commenced were such that, under the provisions of Section 34 of the Income Tax Act, 1918, the Company was able to obtain a return of the tax which it had suffered by deduction at the source in respect of its income from investments.

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It is clear that down to December, 1936, the Appellant Company was not an " investment company " within the meaning of Section 20 of the Finance Act, 1936, because down to that time it had two sources of income, namely, income from its investments and income from its trade, and its income from trade was much the larger. But, during 1937 and during the three months of 1938 before the winding up, its investment income was the only income that it possessed.

Two points are raised. The first is that the Commissioners could not on these facts, as a matter of law, find that the Appellant Company was an investment company; and the second is that the word " income " in Section 20 (1) means the net income of the Company from all sources, so that if the trade losses exceed the investment income the Company cannot come within the definition in Section 20 (1) of the Finance Act, 1936, because it has no income.

With regard to the first point, I think the Solicitor-General is right in saying that whether the Company is or is not an investment company at the date of the commencement of its liquidation is a question of fact, and the decision of the Commissioners on that point is final, unless it can be shown that they have erred in some matter of law. I think he is right also in saying that you cannot lay down any period of time preceding the commencement of the liquidation during which the income of the Company must have consisted mainly of investment income, because that must depend on the particular circumstances of each case.

So far as the circumstances of this case are concerned, I see no ground for holding that the facts are such that the Special Commissioners could not properly come to the conclusion that this was an investment company within the meaning of Sub-section (1) of Section 20 at the date when the winding up resolution was passed.

The second point seems to me to be more difficult. It is said in fact during the fifteen months preceding the commencement of the liquidation, the Company had no income at all because the loss incurred on its trading account was greater than the amount of the investment income which it received. The position is the same as that of an individual in receipt of a salary who, at the same time, carries on the business of a farmer and makes a loss on his farming operations greater than the amount of his salary. Can it be said that such an individual has no income? I think not. He has an income by reason of his salary. He has no " taxable income " because under Section 34 of the Income Tax Act, 1918, he can set off the losses on his farm against his liability to tax on his salary. But I do not think it can be said that he has no income. Moreover, if the word " income " in Section 20 (1) of the Finance Act, 1936, was intended to mean taxable or net income, one would expect it to be so expressed. Therefore, in my view, the Special Commissioners were right in saying that the Appellant Company was a company the income whereof at the date of the commencement of the winding up consisted mainly of investment income. It had, indeed, no other income at all.

In my opinion, therefore, the Special Commissioners were right and this appeal fails and must be dismissed with costs.

An appeal having been entered against the decision in the King's Bench Division, the case came before the Court of Appeal (Scott, Goddard and du Parcq, L.JJ.) on 8th, 9th and 10th February, 1943, when judgment was reserved. On 12th March, 1943, judgment was given in favour of the Crown (Scott, L.J., dissenting), with costs, confirming the decision of the Court below.

Mr. J. Millard Tucker, K.C., and Mr. F. Heyworth Talbot appeared as Counsel for the Appellant Company, and the Solicitor-General (Sir David Maxwell Fyfe, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Scott, L.J.—This appeal is from a decision by Macnaghten, J., dismissing an appeal by way of a Stated Case from the Special Commissioners, who had held that the Appellant Company, to which Section 21 of the Finance Act, 1922, admittedly applied, was also an " investment company " within Section 20, Sub-section (1), of the Finance Act, 1936; with the statutory consequence under Sub-section (6) of the same Section, that, as the Company had on 1st April, 1938, passed a resolution for voluntary winding up, its actual income from all sources subsequent to the date of the resolution became liable to a direction by the Special Commissioners that it should " be deemed " to be the income of its members ". Such a direction was in fact given; hence this litigation. The issues on the appeal to us turn entirely on the proper interpretation and application of Sub-section (1). Sub-section (6) is merely consequential. The year of assessment in question is 1938–39.

The Company was formed as long ago as 1912, and had from that date carried on a trade, the income from which was assessed and charged under Schedule D. Its trade consisted of buying and selling securities, indemnity issues, and other financial business. In addition it had, at any rate during the last seven or eight years, accumulated considerable investments from which it derived income. A table (Exhibit " B ") of its financial career during the eight years since 31st March, 1930, as found by the Commissioners, is annexed to the Case, and shows that its trade had been conducted up to the end on a large scale. In the first two of the eight years it made, in round figures, trading losses of £9,000 and £11,000; in the next 4¾ years (it having evidently towards the end of that period decided to change its accountancy year to make it end on the 31st December), it earned nearly £1,000,000 profit; but in the 12 months to 31st December, 1937, it made a loss of £412,464 (almost wholly due to a fall of market prices) which necessitated a very drastic writing down of stocks; and in the last three months of the fiscal year 1937–38 a further loss of £72,202. During the first two of this period of eight years its investment income was negligible; but in the next four accountancy periods (the last being 21 months) it received a gross investment income of £5,000, £9,000, £45,000 and £225,000, in round figures; and in the last two periods of 12 months and three months (when the trading business was earning no income, but making immense losses) the gross investment income was respectively £82,145 and £11,668. The case for the Crown in the appeal is that these receipts were " income " of the Company, and that the much larger figures of the trading losses must be wholly disregarded.

There is no suggestion whatsoever that the Company had been formed, or that its business had at any time been conducted, or its accounts framed, for the purpose of enabling its " members " (as defined by the various Finance Acts passed for the purpose of preventing evasion by Sur-tax payers) to avoid Super-tax or Sur-tax, or in any way to offend against the spirit of the preamble to Section 21 of the 1922 Act. The Commissioners find that the trading losses in the last 15 months were in fact incurred, and annex all necessary accounts. They also record the fact that for the fiscal year 1937–38 the Company claimed relief under Section 34 of the Income Tax Act, 1918, by reference to the trading loss of the last 15 months before the winding up, and that its claim was allowed; and they annex a copy of a letter to that

effect from the Inspector of Taxes, dated 23rd September, 1939, attaching his explanatory figures for the "Year 1937–38 as finally agreed." The communication shows that the Commissioners of Inland Revenue reimbursed the Company overpaid Income Tax to the full extent of the Company's trading losses, as required by Section 34.

Whilst paying due respect to the maxim that hard cases make bad law, I have thought it desirable to preface the inquiry into the proper interpretation of the Statute by the preceding statement of the simple facts about the Company, whose affairs are the subject of the appeal; for, in my view, it is not a case where the individuals behind and in control of the Company are in any sense within the mischief to the remedy of which this compartment of our taxing legislation is addressed. If they are hit, it is not because they are aimed at, but because they just happen by accident to be within the line of statutory fire. In short, it is important to clear our minds of any sub-conscious prejudice due to a suspicion that the Appellant Company is just one more example of the devices for tax evasion against which Parliament has been obliged to provide so many different counter-devices for the protection of the revenue since it passed Section 21 of the Finance Act, 1922. The Appellant Company is admittedly a private company controlled by less than five individuals, and therefore one to which the legislation in question *can* apply; the only question is whether it does apply. Equally no question of company law or policy about one-man companies comes even remotely into the field of relevance. That topic is in no way germane to the Sur-tax question, into which we have to inquire today.

Section 20, Sub-section (1), of the Finance Act, 1936, is as follows: "The "following provisions of this section shall have effect as respects companies "(hereafter in this section referred to as 'investment companies') the "income whereof consists mainly of investment income, that is to say, income "which, if the company were an individual, would not be earned income as "defined in subsection (3) of section fourteen of the Income Tax Act, 1918". Sub-section (6) provides that on a resolution of winding up of an investment company to which the Finance Act, 1922, Section 21, applies: "(*a*) the "actual income of the company from all sources since the date of the order "or resolution shall, for purposes of assessment to surtax, be deemed to be "the income of the members"; (*b*) provides for notice from the Special Commissioners to the liquidator that the company's income for Sur-tax is to be deemed to be the income of the members; (*c*) contains rules as to procedure. The Special Commissioners who heard the appeal state the contention of the Commissioners of Inland Revenue very shortly in paragraph 9 of the Case: "For the Respondents it was contended that on the "evidence the Appellant Company was at the date of liquidation, and had "been for a period of 15 months prior to 1st April, 1938, deriving income "solely from investments. These facts were sufficient to bring it within "Section 20 for the year 1938–39." The Special Commissioners accepted that contention, and therefore confirmed the direction already given to the liquidator of the Company under Sub-section (6), that the Company's income was to be deemed the income of the members for the purposes of Sur-tax.

Before us two main contentions were urged on behalf of the Appellant Company by Mr. Tucker and Mr. Talbot. The first was that the Company was not an investment company because throughout its business life, and, anyhow, during its last eight years, it had obviously been an ordinary financial trading company and could not, or, at any rate on the proved facts, did not change its nature, either because or when its business, though still

continuing, became unprofitable and had to be carried on at a loss instead of a profit. Conversely, they put their argument in the positive form of a contention that a substantial length of time must elapse in order to constitute a sufficiently representative period to justify an inference that the Company had changed its character. They urged further that, even if the criterion laid down in the Sub-section by the words " the income whereof consists mainly " of investment income " in contrast with " earned income " ought to be regarded as a definition, the word " consists " imports not a momentary phenomenon, but something persistent and habitual. Their second contention was that, even if a mere moment of time has to be regarded, it could not be said of *this* Company at any relevant moment, however chosen, that its " main " income had any particular character, for the simple reason that it had no income at all; its total income having been reduced by its trading losses to less than nothing; and to speak of its investment income as having a positive existence when its trading loss so far overbalanced it as to cause a minus result, is so absurd as to make it impossible to conclude that Parliament can have intended it.

I confess to a feeling of sympathy with this commonsense argument, but the answer of the Solicitor-General is formidable. His first criticism is that the Appellants' second contention misinterprets the word " income ". In Income Tax legislation that word must be construed in its Income Tax meaning, that is, as income assessed and charged under one or other of the five Schedules; unless it is expressly qualified as " total income ", or " total " income from all sources ", or " aggregate income ". Consequently, as the Company's investment " income " has been taxed by deduction at the source, and properly so taxed, it remained and still was income. Further, as by reason of its trade losses the Company had no " income " of the Schedule D kind, and no other kind of income was suggested, the investment income was not merely the Company's " main " income, but its only income.

The Solicitor-General then proceeded to answer the Company's first argument, namely, that the Company could not in a moment of time suddenly change its character, or, as I ventured to suggest to Mr. Tucker, change its colour like a chameleon; that a representative period must be taken, which, on the facts of the present case, would reach back into the Company's profitable trading years. The Solicitor-General's answer was in effect that the appellation " investment company " is not a substantive description, but a mere label adopted for drafting convenience in order to facilitate subsequent references; and that Sub-section (1) says nothing about the character of any company, but merely enacts that if the income of any company is " mainly " derived from investments the statutory consequences will automatically follow, including the appellation " investment company ". He then took what he regards as his final step in logic, by pointing to the fact that the Company still possessed for purpose of charge its investment income as shown in the assessment which in the absence of appeal had become " final and conclusive ".

The case so presented to us by him appeared powerful, and I confess to having found it difficult to meet. It seemed so faithfully to comply with the language of the Section. And yet the result was so much at variance with the object of the legislation in a case like the present, where there is not a single symptom of the mischief against which this network of special legislation has been directed, that I hesitated to accept his argument as sufficient; and on the whole I have come to the conclusion that it is wrong. Mr. Talbot in his reply gave us the clue to what I think, though not without doubt, is the true solution. It is to be found in the Finance Act, 1927, Section 42, Sub-

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section (4), and the application of that provision to an " adjustment " of income (or of tax on income as per Section 40, Sub-section (1), of the Finance Act, 1927) under Section 34 of the Income Tax Act, 1918. Section 42 occurs in the fasciculus of Sections 38 to 47 constituting Part III of the 1927 Act, which effected the change from Super-tax to Sur-tax. Section 38 was concerned with total income from all sources, just as was Section 5 of the Income Tax Act, 1918. Section 42, Sub-section (1), made Sur-tax " due and payable " as a *deferred instalment of income tax* on or before the first day of January " next after the end of the year of assessment for which it is payable "; but Sub-section (2) is as follows: " Sur-tax shall be assessed and charged by the " Special Commissioners, and, notwithstanding anything in the Income Tax " Acts providing for the separate assessment of income arising from different " sources, shall be assessed and charged in one sum."

The important Sub-section, however, is (4): " Where an assessment to " income tax made at the standard rate has under the provisions of the " Income Tax Acts become final and conclusive for any year, the assessment " shall also be final and conclusive for the purpose of estimating total income " for the purpose of sur-tax for that year, and no allowance or adjustment " of liability on the ground of diminution of income or loss shall be taken " into account in estimating the total income for that purpose, unless that " allowance or adjustment has been previously made in respect of the income " tax charged at the standard rate on an application under the special " provisions of the Income Tax Acts relating thereto."

That Sub-section is (save for slight changes of phraseology due to one or two later Finance Acts which are immaterial for present purposes) an exact repetition of Section 5, Sub-section (2), of the Act of 1918. Its effect is to make an assessment under one or other of the Schedules A to E, which has become final and conclusive for Income Tax purposes by reason of there having been no appeal from the General or Additional Commissioners, also final and conclusive for Sur-tax; but subject to the extremely important exception, namely, of an adjustment of liability in respect of Income Tax made " on an application under the special provisions of the Income Tax " Acts relating thereto." The relevant " special provision " in the present appeal is Section 34 of the Income Tax Act, 1918, under which the repayment was in fact made to the Company of the tax deducted at the source on its investment income. The wording of Section 34 is—an application " for an " adjustment of his (the taxpayer's) liability by reference to the loss and to " the *aggregate* amount of his income for that year estimated according to this " Act." On such an application being granted Sub-section (2) of Section 34 makes repayment of Income Tax obligatory.

If it be said that there remains any ambiguity in Section 42, Sub-section (1), of the Act of 1927 which adds a further doubt about my solution, I think the general considerations which I stated in the earlier part of this judgment justify a beneficial interpretation of the Sub-section in favour of the taxpayer. In this context it is worth noting that, as the old Super-tax was an *"additional"* duty of Income Tax (Section 4 of 1918), so Sur-tax is a deferred payment of Income Tax. In either case whether Section 5, Sub-section (2), of the Income Tax Act, 1918, or Section 42, Sub-section (4), of the Finance Act, 1927, be considered, if the Income Tax foundation on which the higher tax rests be removed the superstructure of Super-tax or Sur-tax cannot be left in the air; it too ceases to exist.

For these reasons I am of opinion, though with doubt, that this appeal should succeed, with costs here and below; the judgment of Macnaghten, J., be set aside and the case remitted to the Special Commissioners to act

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accordingly; but my brethren think otherwise, and the Order will be as they direct.

Goddard, L.J.—The Appellant Company was at all material times one to which Section 21 of the Finance Act, 1922, applies, and the first question on the case is whether it is also an " investment company " within Section 20 of the Act of 1936. The second question is whether, assuming it is an investment company, it can be said to have any income at all for the financial year 1938-39.

It is an investment company if its income consists mainly of what in the case of an individual would not be earned income. This Company carried on a business of buying and selling stocks and shares, and, like all companies carrying on such a business, had large holdings of securities from which it derived a dividend income. For two years ending 31st March, 1931 and 1932, it traded at a loss; for the next three periods of 12 months and the succeeding 21 months ending 31st December, 1936, it traded at a considerable profit; for the 12 months ending 31st December, 1937, and the succeeding three months it sustained large losses on its trading, far exceeding what it received from its investments. On 1st April, 1938, it went into voluntary liquidation. The Special Commissioners have held that for the 15 months before liquidation it was an investment company and have upheld, as has Macnaghten, J., a direction made upon it for the year of assessment 1938–39, under the provisions of the two Sections referred to above. It is objected that there was no evidence upon which the Commissioners could find that this was an investment company because, it is said, they must look not only at that period of 15 months, but must take what was called a representative period, by which I understand is meant that they ought to survey some period anterior to that in which the Company made a loss, and if they find, as they must have done, that the Company was then in receipt of a trading income in excess of its investment income, they must find that it was not an investment company. One difficulty in accepting this argument is that no one could suggest any test as to what is a representative period. But the overriding difficulty, in my opinion, is that to do so would be to substitute a different test for ascertaining what is an investment company from that which the Act provides. The test is not whether the company had been carrying on or was continuing to carry on a business, but simply whether its income consists mainly of a particular class of income. Therefore a company can be at one time an investment company and not at another. In my opinion all that has to be regarded is the income during the financial year in question. Whether the test is satisfactory or whether it works hardship in a particular case is not a matter which can be taken into account. Suppose the figures showed that for the three or four years this Company's income had been mainly investment income and then for a particular year there had been a change and its income was mainly earned; I do not suppose the Company would have contended that it remained for that year an investment company. On this point I am of opinion that the decision, both of the Special Commissioners and the learned Judge, was right.

The second question is more difficult, but I agree with the Special Commissioners and the learned Judge. The case is concerned with the period after the date of liquidation. It seems to me that the Company had an income in the year 1937–38, though not a taxable income. An individual often has an earned and unearned income. If the former ceases because he makes a loss, but he receives money from his investments, in my opinion he still has an income, though he will not have to pay tax upon it if the loss exceeds the income. Sur-tax is a deferred instalment of Income Tax, so no

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one can have an income subject to Sur-tax if he has not one upon which Income Tax is chargeable. But a company does not pay Sur-tax, and we have not to consider therefore whether its income is liable to Sur-tax or even Income Tax, but simply whether it has an income of a particular description. If it has income for Sur-tax purposes it is to be regarded not as the income of the Company but of its members.

In my opinion, therefore, the Company was at the date of the liquidation an investment company, and consequently the direction against which the appeal is brought was validly given.

du Parcq, L.J.—The question in this case is not whether the Appellant Company would normally be described as an " investment company ", but whether it falls within the class of companies to which the label " investment " companies " is applied by Section 20, Sub-section (1), of the Finance Act, 1936. If one reads into that Section the material words from Section 14, Sub-section (3), of the Income Tax Act, 1918, the question assumes the following form: Can it be predicated of this Company that its income consists mainly of income which, if it were an individual, would not be charged under Schedule D or the Rules applicable to Schedule D? (I omit for the sake of simplicity the words which provide that income, to be " earned " income ", must be derived from the exercise of a trade, profession or vocation.)

If it is proper to look only at the period of 15 months to 1st April, 1938, for the purpose of ascertaining the status of the Company, I think that there can be no doubt that the Schedule D income was nil. The Company in fact made a large trading loss.

The next question is whether the Company had any income other than Schedule D income. If the answer to that question is " Yes ", then it follows that its income " consists mainly " of non-Schedule D income. The Crown says that the answer is " Yes ", because the Company received in dividends from its investments £82,145 in the 12 months ending 31st December, 1937, and £11,668 in the three months ending 1st April, 1938. For the Appellant Company it is contended that the answer is " No ", because although it received dividends they were not truly income. The Company, it is said, had no income, because its trading loss swallowed up its " unearned " profits and left it with nothing. It is pointed out that, for the purposes of taxation, an application could be, and was, made by the Company which properly resulted in its paying no tax on its dividends: the tax deducted at source was returned to it.

In my opinion the contention of the Crown is right. The subject who " sustains a loss " in trade may apply to the Commissioners " for an adjust- " ment of his liability by reference to the loss and to the aggregate amount " of his income " for the year " estimated according to " the Act(1). It is, I think, true to say that the " aggregate amount " of the Company's income over the 15 months was nil, but, in my opinion, Section 20, Sub-section (1), of the Finance Act, 1936, requires us to look not at the aggregate income, but at two categories of income, (1) earned and (2) everything that is not earned, and to compare them. If under category (1) we find a loss, and under category (2) a profit, that is for this purpose immaterial, the object of the Section being to classify a company according to the character of its income from various sources, and not to arrive at the true aggregate of its income. If the Company had made a profit of £5 or £10 by trading activities, and of many thousands in the form of " investment income ", there could be no

(1) Income Tax Act, 1918, Section 34 (1).

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question that it would fall within Section 20, Sub-section (1). It appears to me that it is no less clearly within the Sub-section when we find that instead of making a small profit it has incurred a heavy loss by its trading activities.

I have had the advantage of reading, and have carefully considered, the judgment of Scott, L.J. I am unable, however, to agree with the view that Section 42, Sub-section (4), of the Finance Act, 1927, concludes the question. That Sub-section relieves the payer of Sur-tax, as well as the Income Tax payer, of liability in so far as an allowance or adjustment has been made on the ground of diminution of income or loss. For that purpose the taxpayer's " total income " has to be ascertained. For the reasons which I have already given I think that we are not here concerned with " total " income. Nor are we concerned with the liability of the Company to taxation. Its character has to be ascertained according to the rule laid down. If it is properly characterised as an " investment company " at the time when it goes into liquidation, from that time on its " actual " income (which, during the winding up presumably will not be diminished by any trading loss) must be " deemed to be the income of the members ".

The question remains whether it was proper to treat the 15 months ending 1st April, 1938, as the relevant period. If due regard is paid to Sub-section (6) of Section 20 it is, I think, clear that what has to be ascertained is the status of the Company at the date of the winding up. Was it then a company of the class " referred to as ' investment companies ' " in Section 20, Sub-section (1)? I find it impossible to say that this question could not properly be answered by looking at the results of the Company's activity during the last financial year and the few months beyond the end of the financial year which ended in liquidation.

I feel the force of all that Scott, L.J., has said as to the probable intention of the Legislature and the inequitable result which may be thought to follow from the construction which I have adopted. It may be enough to say with regard to these considerations that, where the construction of a taxing Act appears to be reasonably plain (and in the present case I feel no real doubt about it), there is no room for speculation as to the policy of Parliament or the justice or injustice of the result. I would venture to add, however, that it is, I believe, notorious that the Legislature does not always succeed in the difficult task of using language at once so comprehensive and so nicely adapted to every possible case as to achieve the ideal result that while no one whom it is intended to tax shall ever escape, yet no one who has a reasonable claim to immunity shall ever be caught.

I agree with Goddard, L.J., that this appeal should be dismissed.

Mr. Stamp.—The appeal will be dismissed with costs?

Scott, L.J.—Yes.

Mr. Tucker.—I am instructed to ask for leave to appeal in this case.

Scott, L.J.—Address your observations to my brethren.

Goddard, L.J.—Yes.

Mr. Tucker.—If your Lordships please.

An appeal having been entered against the decision in the Court of Appeal, the case came before the House of Lords (Viscount Simon, L.C., Viscount Maugham and Lords Atkin, Russell of Killowen and Porter) on 7th, 8th, 9th, 10th and 14th February, 1944, when judgment was reserved. On 19th May,

1944, judgment was given against the Crown (Lord Russell of Killowen dissenting), with costs, reversing the decision of the Court below.

Mr. J. Millard Tucker, K.C., and Mr. F. Heyworth Talbot appeared as Counsel for the Appellant Company, and the Solicitor-General (Sir David Maxwell Fyfe, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Viscount Simon, L.C.—My Lords, this is an appeal from an Order of the Court of Appeal (Goddard and du Parcq, L.JJ.; Scott L.J., dissenting) which dismissed an appeal by the Appellant Company from a decision by Macnaghten, J. That learned Judge had dismissed an appeal by the present Appellant Company upon a Case stated by the Commissioners for the Special Purposes of the Income Tax Acts and had affirmed the determination of the said Commissioners in favour of the Crown.

The question to be decided is whether the Appellant Company at the date of its going into liquidation, namely, 1st April, 1938, was an " investment " company " as defined in Sub-section (1) of Section 20 of the Finance Act, 1936. If it was (since it was admittedly a company to which Section 21 of the Finance Act, 1922, applied—see Sub-section (6) of that Section, together with Section 19 (1) and (2) and Section 20 (3) of the Finance Act, 1936) then, upon a direction of the Special Commissioners addressed to the liquidator on 11th January, 1940, to that effect, the income of the Appellant Company for the year ended 5th April, 1939, was for the purposes of assessment to Sur-tax deemed to be the income of the members. The result of this would be that income assessed to Sur-tax of each of three ladies who were members or loan creditors of the Company was increased by between £5,000 and £6,000, whereas if the Company did not fall within the definition of an " investment " company " in Section 20 of the Act of 1936, the profits of the Company since the liquidation would not attract Sur-tax at all, either in the hands of the Company or in the hands of the three individuals, because when distributed to them in the liquidation the amount would be in the nature of capital received by them.

An " investment company " is defined in Section 20 (1) of the Act of 1936 as a company " the income whereof consists mainly of investment income, " that is to say, income which, if the company were an individual, would not, " be earned income as defined in subsection (3) of section fourteen of the " Income Tax Act, 1918 ". The definition of earned income there referred to is the definition used to decide, in the case of an individual, the deduction which he may be allowed in assessing his income for the purpose of Income Tax on the ground that his income, or part of it, is " earned income ". Income derived from carrying on a trade or profession or from an employment of profit is, for example, " earned "; income from investments—at any rate if they do not arise from carrying on a trade—is " unearned ".

The Case Stated finds that the Appellant Company, before going into liquidation, carried on a general financial business including underwriting and dealing in options, but that the main business of the Appellant Company was that of dealing in stocks and shares. An exhibit to the Case showed that for four successive periods beginning with 1st April, 1932, and ending with 31st December, 1936 (the last being a period of 21 months owing to a change in the date up to which the Company made up its accounts), large profits had been made from the Company's main business and a considerable though smaller profit from dividends from investments. During these years, therefore, the Company could not have been regarded as an investment

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company within the definition. For the twelve months following however (1st January, 1937, to 31st December, 1937) the Company's trade of dealing in stocks and shares was carried on at a loss of £412,464, and for the next three months up to the date of liquidation (1st April, 1938) also at a loss of £72,202; while the income from investments during these respective periods was £82,145 and £11,668, respectively.

Two objections are urged against the view, which has prevailed in the Courts below, that the Company is an " investment company " within the definition. The first is that, for the last 15 months before liquidation, the Company's receipts from investments were more than counterbalanced by its trading losses, and therefore, it is argued, it had no " income " at all. Its income, therefore, could not " consist " of anything. On this view a company which is suffering a trading loss could not fall within the definition unless its investment income was greater than its trading loss and left it on balance with an " income ".

The second objection taken is that, in deciding whether the Company at the date of liquidation was an " investment company ", the Commissioners should not have limited their review to the fifteen months prior to the date of liquidation, but should have considered the history of the Company as a whole.

As regards the first objection, du Parcq, L.J., in a most careful judgment, has advanced the view that Section 20 (1) of the Act of 1936 requires us to look at two categories of possible income, (*a*) earned income, and (*b*) investment income, and to compare their size. If under category (*a*) we find a figure of loss and under category (*b*) a figure of profit, the company's main income consists of investment income and the definition applies notwithstanding that the figure of investment profit is the smaller of the two[1].

With all respect to the Lord Justice, I am unable to accept this application of the Sub-section. It is true that the Sub-section requires us to ascertain the amount of the investment income. But the Sub-section does not in terms require us to ascertain as a separate item of account the amount of the earned income, or to compare that amount with the ascertained amount of the investment income. What the Sub-section does require is that this last-mentioned amount should be compared with the amount of the company's " income ". An investment company is defined by the Sub-section as a company the " income whereof consists mainly of investment income ", and I can see no sufficient reason for giving to the words " income whereof " contained in the Sub-section anything other than the meaning they ordinarily bear in legislation, such as this is, which is concerned with the imposition of Sur-tax, namely, income from all sources ascertained in accordance with the Income Tax Acts. This, too, is in substance the meaning given to the word " income " in the world of commerce. If a company in the course of a year's trading carries on its business at a loss exceeding in amount the investment income received during the year, its income for the year would be described among business men as having been nothing. But if the company's income be nothing, it cannot be said to consist, whether mainly or otherwise, of any particular item of income. As it does not exist it cannot " consist " of anything.

The view I take is, I think, confirmed by the fact that in such a case as this, the taxpayer can claim repayment of Income Tax suffered on investment income (under Section 34 of the Income Tax Act, 1918) " by reference " to the loss and to the aggregate amount of his income for " the year.

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(1) *See* page 140 *ante*.

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In my opinion a company such as I have described above is not an investment company within the meaning of the Sub-section.

It has been suggested that the use of the words " income from all sources " found in Sub-section (6) of Section 20 indicates that the word " income " in Sub-section (1) must have been used by the Legislature in some narrow sense. I am not impressed by this argument. The object of Sub-section (6) is in substance to make applicable to investment companies in liquidation the provisions of (amongst others) Section 21 (1) of the Finance Act, 1922. In that Sub-section the income of a company that is dealt with is referred to as its income from all sources and it was only to be expected that Sub-section (6) of the Act of 1936 making Sub-section (1) of the earlier Act applicable to investment companies in winding up should have used the same language as is to be found in such earlier Act.

Having reached the view that the first objection is well founded, it is not necessary for me to deal exhaustively with the second. But I may observe that, if a company's history of trading has been that of a finance company (as opposed to an investment company), the fact that in two periods, while carrying on this same type of business, it makes losses on its stock and share dealings, and can only bring in on the credit side dividends and interest on its investments, does not seem to me of itself to effect a change in the character of the company.

My Lords, I would allow the appeal.

Viscount Maugham (read by Lord Macmillan).—My Lords, this appeal raises a point with a deceptive appearance of simplicity, as to the true construction of a few ordinary words contained in Section 20 (1) of the Finance Act, 1936. What in that Sub-section is the true meaning of the sentence " companies . . . the income whereof consists mainly of investment " income "? There has been a difference of opinion as to the answer in the Court of Appeal, and there is a difference of opinion in your Lordships' House; and I will readily admit that the question is one of considerable difficulty. I shall therefore express my view with great deference to those who have held or hold a different one and with more elaboration than I should otherwise have thought necessary.

The facts are contained in the Case Stated, and the relevant Sections of the various taxing Acts have also been cited, and I do not think it is necessary for me to repeat them. The appeal is against a direction made upon the Appellant Company for the year of assessment 1938–39 under the provisions of Section 21 of the Finance Act, 1922, as extended by the provisions of Section 20 of the Finance Act, 1936. On 1st April, 1938, the Appellant Company passed a resolution for winding up. The question is whether, at that date, it was an " investment company " within the meaning of Section 20 of the Finance Act, 1936, and that depends on whether its income consisted " mainly of investment income ". If it was an " investment " company " within the meaning of that Section at the date of the commencement of the winding up, then (under Sub-section (6)) the actual income of the Company from all sources since that date is deemed to be the income of the members for purposes of Sur-tax. It should be noted that the Sub-section is no longer law (see Finance Act, 1927, Section 31, and Finance Act, 1936, Section 35).

It is not in dispute that the Company was one to which Section 21 of the Finance Act, 1922, applies. The direction of the Commissioners was clearly made on the footing that the Company was an " investment company ".

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The main question being whether that is correct, two points were raised below by the Appellants, and were argued before your Lordships.

The first was that upon the facts of the case the Commissioners were not entitled as a matter of law to find that the Appellant was an investment company, and that their decision had been arrived at by examining only the period of fifteen months immediately preceding the date of liquidation, whereas they should have taken into account also the accounting periods prior to the period of fifteen months. The second was that the word " income " in Sub-section (1) of Section 20 of the Finance Act, 1936, means total income from all sources; and that, as the Appellant's trading losses in the period selected by the Commissioners for review exceeded its investment income for the same period, it had no total income from all sources for that period and consequently could not be brought within the terms of the definition of " investment company ".

Mr. Tucker for the Appellant sought to raise another point which, however, was not raised below or before the Commissioners, and sought for the first time to dispute the view that all the investment income of the Company was " unearned income " within the meaning of Section 14 of the Income Tax Act, 1918. Your Lordships, however, took the view that such a contention was not now open to the Appellant.

My Lords, in approaching the question of the meaning of the words in Section 20 (1) of the Act of 1936, it is necessary to begin the inquiry by observing that Part II of that Act (which relates to Income Tax and contains Section 20) has to be construed as one with the other Income Tax Acts (see Section 35 (3)). We must therefore bear in mind that Sur-tax (like the old Super-tax) is payable by a person on his total income from all sources estimated in accordance with the provisions of the Income Tax Acts (see Income Tax Act, 1918, Section 5, and Section 38 (2) of Finance Act, 1927). He is accordingly entitled to the benefit of Section 34 of the Income Tax Act, 1918. It was no doubt thought obvious that you could not truly ascertain, still less could you justly tax, the total income of an individual for the purposes of an additional duty of Income Tax without deducting a loss sustained by him in any trade, profession, employment or vocation, or in the occupation of lands, as mentioned in Section 34. I will add that, speaking generally, it is true to say that " income " as the word is used in the Income Tax Acts refers to a balance of annual profits and losses made or sustained by a person, always remembering that it is not intended to tax capital. The five Schedules A, B, C, D and E and their respective Rules were designed as convenient machinery for taxing in the hands of an individual every kind of property yielding income (see *London County Council* v. *Attorney-General*, [1901] A. C. 26, per Lord Macnaghten at pages 35/37(1)). The word " income " is sometimes expressly applied in relation to income chargeable under a particular Schedule; but in other cases it is not infrequently found in the Acts as meaning " income from all sources " without the addition of the latter words.

Super-tax, like Sur-tax, was always leviable on individuals, and not on companies or societies. It was not till the year 1922 that the Legislature (by the Finance Act, 1922) thought it expedient to exact Super-tax on the undistributed income of certain companies, " with a view to preventing the " avoidance of the payment of super-tax through the withholding from " distribution of income of a company which would otherwise be distributed " —see the opening words of Section 21 of the Finance Act, 1922. The Section

(1) 4 T.C. 265, at pp. 293/5.

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leaves it to the Special Commissioners to decide whether the company has distributed a reasonable part of " its actual income from all sources " for the period in question, having regard not only to the current requirements of the company's business, but also to such other requirements as may be necessary or advisable for the maintenance and development of that business. Subject to that important provision, the Commissioners may, in an appropriate case, direct that " the said income of the company " shall for purposes of assessment to Super-tax *be deemed to be the income of the members* and the amount is to be apportioned among them. The Super-tax chargeable is then to be assessed upon the members in the name of the company and, unless the members elect to pay the tax, it must be paid by the company.

The Crown makes no question as to the meaning of the words " actual " income from all sources " of a company. It is expressly provided in the First Schedule, Paragraph 6, to the Act of 1922, that in computing its income from all sources the income from any source shall be estimated in accordance with the provisions of the Income Tax Acts relating to the computation of income from that source, computed, however, by reference to the income of the year or period in question. Whether because of this provision or on some other ground, it is admitted that Section 34 of the Act of 1918 must apply to the computation of " the actual income from all sources "—see also Paragraphs 5, 8 and 9 of the same Schedule.

Two methods of evading Sur-tax were discovered in due course. One was in connection with certain loan creditors of a company, who received out of the income of the company moneys in or towards the redemption, repayment or discharge of their loans. The other was by the device of holding up the distribution of dividend and then at a suitable time putting the company into liquidation and distributing the assets in the liquidation, with the result that the shareholders would escape Sur-tax. It was in these circumstances that the Legislature passed into law the Section which is now under consideration.

Section 20 of the Finance Act, 1936, begins with what is in effect a definition of " investment companies " as follows:— " (1) The following " provisions of this section shall have effect as respects companies (here- " after in this section referred to as ' investment companies ') the income " whereof consists mainly of investment income, that is to say, income which, " if the company were an individual, would not be earned income as defined " in subsection (3) of section fourteen of the Income Tax Act, 1918 ". There followed four Sub-sections as to certain loan creditors of companies described as " investment companies " to which Section 21 of the Finance Act, 1922, was applicable. These provisions applied to such companies as going concerns.

Then came Sub-section (6), under which the present case arises: " (6) Where, whether before or after the passing of this Act, an order has " been made or a resolution passed for the winding-up of an investment " company to which section twenty-one of the Finance Act, 1922, applies, " the following provisions shall have effect:—(*a*) *the actual income of the* " *company from all sources* since the date of the order or resolution shall, " for purposes of assessment to surtax, be deemed to be the income of the " members; (*b*) the Special Commissioners shall from time to time by notice " in writing to the liquidator direct that the amount of that income for the " year or period specified in the notice shall be deemed for those purposes " to be the income of the members for that year or period, and the amount " thereof shall be apportioned and surtax assessed and charged accordingly;

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" (*c*) the provisions of the said section twenty-one and any provisions of this " or any other Act relating thereto shall, with any necessary modifications, " apply in relation to any such directions, apportionments and assessments " as they apply in relation to directions, apportionments and assessments " under subsection (1) of the said section twenty-one."

It is agreed that " the actual income of the company from all sources " since the liquidation must be estimated for the purposes of this Sub-section after deducting losses on income account; but it is contended on behalf of the Revenue that the words " companies . . . the income whereof consists mainly " of investment income " contained in the definition above set forth, do not permit of any such deduction. The result in the case under appeal, according to that view, is that we must disregard the fact that the Company in the 12 months to 31st December, 1937, made a loss on its trade of £412,464, and in the three months thereafter to 1st April, 1938 (the date of liquidation) made a trading loss of £72,202. There were gross taxed dividends on the Company's investments of £82,145 and £11,668 for the two periods mentioned. The income of the Company, according to the Commissioners, therefore, is mainly investment income; the Company is an " investment " company ", and Sub-section (6) (*c*) of Section 20 must necessarily apply in the winding up.

That, if correct, is a strange result, for it is apparent that the Company could not have distributed any dividends whatever in either of the two periods. Assuming the Section to be one of a penal nature, a *lex poenalis*, it is a little odd to find it applied in cases where there is neither *delictum* nor *maleficium*. Such, of course, may be the result of the words used; but for my part I am not disposed to construe the words in the definition of investment companies in such a way as to create or to add to obvious injustice unless I am compelled by reasonably clear words so to do.

It is important to note at the outset that the words " the income whereof " in the definition plainly must mean " the income whereof from all sources ". They cannot mean the income assessed under some of the Schedules A, B, C, D and E, and not under others. The Sub-section is silent as to any such discrimination. The income of a company, in the absence of qualifying words, must mean the whole of its income, i.e., its income from all sources. If I correctly understand the argument on behalf of the Respondents, this is not in dispute. Of course, the word " income ", if not found in Income Tax Acts which have to be read as one, might refer to the income of the company and, of course, the whole income ascertained according to ordinary commercial principles approved by law; but in the place where the words in question are found they must, I think, refer to income computed according to Income Tax rules. The question then arises whether there is any real difference between the words " the actual income of a company from all sources " and the words " the income of a company " where the words " from all sources " are plainly to be implied. Is there any magic in the word " actual "? If it means " other than notional ", that also, I think, must be implied in Section 20 (1).

My Lords, I have come to the conclusion that the words relating to the income of the company in Section 20 (1) have the same meaning as the words " actual income from all sources " in Section 21 (1) of the Finance Act, 1922. The two Sections, I repeat, have to be construed together as if they were contained in the same Act. After all, we are ultimately concerned merely with Super-tax payable by shareholders. We are dealing with a tax which is essentially chargeable on the total income of individuals, but not on something which must be more than that income as the word is generally used. It is

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not reasonable to suppose that, by the words as to actual income in Section 20 (1) of the Act of 1936, it was intended to disregard the circumstance that for dividend purposes income losses must be deducted from other income before dividends are paid, or to tax shareholders of companies for Sur-tax in cases where they have already paid Sur-tax on all the dividends which the company could properly have paid out of the income of the company. Losses on income account must be deducted, since, generally speaking, a limited company cannot pay dividends out of capital; and the directors and auditors must necessarily have regard to trading losses before declaring dividends. The proposition is a commonplace of company law. To disregard it is to travel on a road to ruin. One should not lightly assume that the Legislature is contemplating that the income of a company should be calculated on the footing that an illegal course is being followed.

In an endeavour to make my next observations clear, I shall describe the " income " of the company in the place where the word first appears in Sub-section (1) as " the income A ", without at first any assumption as to what that word means, and I shall call income of the company which is not " earned income ", as defined, as " the income B ". The Sub-section then tells us that if the company is one of which the income A " *consists* " *mainly* " of the income B, then the company is an investment company. Obviously the income B (if it exists at all) is part of the income A. Now Section 20 of the Act of 1936 consists of amendments of Section 21 of the Finance Act, 1922. It relates both to investment companies within that Section which are going concerns, and also (Sub-section (6)) to cases where an order has been made or a resolution passed for the winding up of investment companies " to which section twenty-one of the Finance Act, 1922, applies ". That Section, however, as I have pointed out, imposes Super-tax on the shareholders on the footing that income from all sources which might have been distributed as dividends has been held up, and shows quite clearly that the income so distributable must be calculated after deduction of losses under Section 34. I am of opinion that this same method must be used in applying Sub-sections (2), (3), (4) and (5) of Section 20 of the Act of 1936 to persons defined as " loan creditors ". These provisions are of a complicated character and I cannot discuss them here. (A brief account of them will be found in Konstam's Law of Income Tax, 9th edition, page 310.) The language of Sub-section (2) seems to me to point clearly to the conclusion that the opinion I have expressed is correct. The proviso as to distribution of a reasonable part of the actual income is framed on the assumption that losses have been already deducted; and I have not heard any reason for supposing that the Legislature when it passed provisions for treating payment of certain loans as distributions of income (for purposes of Sur-tax), was seeking to alter the provisions of Section 21 of the Finance Act, 1922, as to deduction of losses under Section 34. If my view is correct as to Sub-sections (2) to (5) of Section 20 of the Act of 1936, then the definition in Sub-section (1) must necessarily be construed in the way I have above suggested, and it will necessarily apply to Sub-section (6), which relates, as I have said, to the liquidation of investment companies. *Prima facie*, then, I am of opinion that the word " income ", where it is first found in the Section, means actual income of the company from all sources ascertained in accordance with the provisions of the Income Tax Acts.

Is there then some sufficient reason for coming to another conclusion? It is true that in several instances where the taxing Acts wish to refer to income " from all sources " it uses those or equivalent words. Sub-section

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(6) of the Section now under consideration is an example. But it is not very difficult to see why the draftsman added the words in the Sub-section (6), since he was dealing with a conception hitherto unknown under the taxing Acts, namely, with what is described as the " actual income " of a company in liquidation which might not be carrying on any business at all and would not be taxable for Income Tax under the well-known Sections and Rules. The words " from all sources " are, I think, used *ex abundanti cautela*. In any case I am not prepared to attach great weight to the argument that, when in the welter of legislation relating to Income Tax and Sur-tax we sometimes find additional words used to give a precise meaning to the word " income ", a similar meaning may not be given to the word without those additional words.

There is, however, an additional consideration in favour of the *prima facie* view above suggested. So far I have not mentioned the question of the period of time which must be taken for judging whether at the relevant date (which here must be the date of liquidation, 1st April, 1938) the income A of the company consists mainly of the income B—which no doubt means that income B is more than half the amount of income A. The word " income " plainly has no meaning at all where the amount of it is concerned unless we add the factor of time.

I attach some weight to the circumstance that the Sub-section uses the present tense " consists ", and says nothing as to the length of time during which the income has been received by the company. I cannot think that the definition is framed so that a company may be an " investment company ", say, in January, when its trading business is going badly, but is not an investment company, say, in March, when its trading business has recovered. A few pounds one way or the other may make all the difference. I will add that if losses on income account are to be disregarded, the company might well be an investment company the day after a large loss though it had not been one on the previous day or for many years before. The alternative and I venture to think more reasonable view is that the words indicate companies of a particular type or character, judged no doubt by the kind of income which they have normally received. If the investment income B has constituted a major part of the total incoming flow during a period sufficient to enable a fair judgment to be formed as to the character of the company, then the company is stamped as an " investment company ", with the consequences mentioned in the Act. If the company goes into liquidation, the actual income " from all sources since the date of the order or resolution " (for here we get the period mentioned) must for the purposes of assessment to Sur-tax be deemed to be the income of the members. If the argument for the Crown is right the result, as pointed out, may depend on a mere accident. The company may have distributed every penny of its available profits during the period in question, and indeed in every year since its incorporation. It may have " held up " nothing. That, it is said, makes no difference. We are concerned, it is contended, with a mere question of arithmetic; the income A (but without regard to trading losses) during a period unnamed in the Act but selected without guidance from the Act by the Commissioners must be compared with the unearned income B. If the income B exceeds half of the income A, the consequences follow mentioned in the Section. The Act is not concerned with justice or equity, or with ascertaining the true nature of the company's activities. Well, if the Act says so, it must be so; but if the language used permits of another interpretation with a more rational result, my view is that we should adopt it.

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My Lords, with all respect to those who think otherwise, my opinion is that the Sub-section (1) points to the character of the company being ascertained by the nature of its income during a period sufficient for the ascertaining of the real nature of its business and, as I have pointed out, without regard to the question whether the company is or is not in liquidation. The Commissioners are not tied to any particular period and are certainly not confined to the last year of assessment to tax. The Commissioners took a period of 15 months. In the case before us (where the Company has not changed its mode of business) I think it was wrong in law to take a period of great losses in trade owing to enormous depreciation in the trade which was being carried on without also considering the results of the preceding periods. It would not be right to lay down any rigid rule, for every case of the kind must depend on the precise circumstances which bear upon the matter to be determined. I am content in this case to say that I think it was wrong in law not to have regard to the trading income of the Company for the 21 months to 31st December, 1936, which amounted to no less than £633,180, to say nothing of the trading income for the three preceding years. If these periods or the first period alone is looked at the inevitable conclusion must be that the Company was not an " investment company " within the Section.

I must add that, in my opinion, Sub-section (1) of Section 20, now under consideration, does not apply to a case where the company's income from all sources amounts to nil, as was here the fact. I have above given my reasons for the view that upon the true construction of Sub-section (1) the Company's income was in fact nil, and if that is correct it affords a second reason for the conclusion that the Commissioners were wrong in the decision at which they arrived and that the direction they gave was invalid. It cannot, I think, be a fair use of language to say that a non-existent income (the income A) " consists mainly of investment income ".

My Lords, on the above grounds I think the appeal should be allowed, with the usual consequences.

Lord Atkin (read by Lord Porter).—My Lords, I have had the advantage of reading in advance the opinion which has just been delivered by my noble friend Lord Maugham, and I agree with his conclusions and the reasoning by which he reaches them. I find it only necessary to deal generally with the points raised in the case. It seems to me important to bear in mind that we have to deal with a statutory definition of an investment company, contained in Section 20 (1) of the Finance Act, 1936. Why it should be styled by one of the Lords Justices a " label "(1) I cannot think, unless the conception of a definition was considered dangerous to the conclusion about to be reached. It is a definition with a genus " company ", and a *differentia* " mainly investment income ", and the sole question is whether the Company in question, when it went into liquidation, was an investment company as so defined.

Now it has to be noted that the definition cannot be applied merely by considering the position of the Company at any arbitrary date. Whether the income of a company is mainly investment or mainly earned cannot be ascertained in the case of a trading company, such as this admittedly is, until the close of the trading year in which the earned profits, if any, would be ascertained. It is therefore obvious that it is only in reference to yearly results that the definition can be applied. The language used is entirely appropriate to a logical definition of a class or species of company. Does its income consist mainly of investment income? Is one of its attributes

(1) *See* page 140 *ante.*

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mainly investment income? In the case of a company whose known business is trading in securities, which has for several years made large profits in trading, followed by one year, while still trading, of serious losses, I cannot imagine anything more unscientific than the process of arriving at a conclusion by examining the phenomenon of a single and apparently exceptional year. I eliminate the quarter of the year 1938 as adding nothing of value. Of course, if it were established that in the course of the last trading year the company had abandoned its trade, different considerations would apply. But in the present case the Company not only continued to trade in the last year, but made substantial trading profits on its actual transactions for the year, over £80,000, considerably in excess of its income from " investments ". It is only because the stock-in-trade with which the Company had not traded during the year had immensely depreciated by the end of the year that the vast trading loss for the year was arrived at.

I think, therefore, that the application of the definition requires the examination of the Company's activities over a period of certainly more than one year, and that there was no evidence to support the finding that in April, 1938, this was an investment company. The opposite view that a company, while still continuing its ordinary trading, may be an investment company one year and a non-investment company the next, popping in and out of the Inland Revenue pigeon-holes as trade was bad or good, seems to me inconsistent with the language used and from a business point of view to be deprecated.

Mr. Tucker for the Appellants sought to raise before this House for the first time the point that the whole of the investment income was in fact earned income, as it was the direct result of the trading operations of the Company, who in the course of their trading bought and paid for the very dividends which are sought to be contrasted with the earned profits. It was obvious that such a point required an examination of the facts of the trading, which the Commissioners were never invited to make, and that the point was made too late. I express no opinion about it except to say that in deciding the first point I have found it difficult to eliminate from consideration, though I think I have succeeded, the very obvious fact that much of this so-called investment income must in fact be the product of trading, bought and paid for in the course of trade. On such an issue it would seem difficult to distinguish between the purchase of a share cum dividend and the purchase of a cow in calf. However, the effect of such considerations on this Section must remain open.

On the question of income I agree with my noble friend, that to predicate of a company which makes a loss of £400,000 and receives dividends of £80,000 that it has an income of £80,000, appears to be a misuse of ordinary language. I cannot agree with the suggestion of the learned revenue Judge, that if a man receives a salary but makes a loss in passing equivalent to the salary, his income could be said to be the amount of his salary(1). Assume as we may to test the question that he has no other resources but his salary, the end of his trading year would leave him penniless. Would he still say, though I have an income of £2,000 a year, in fact I am penniless? In my opinion, for the reason given by my noble friend, income in the definition means a positive balance of profits and gains for the year, and in the present case the Company had no income in the relevant period. I agree that the appeal should be allowed.

(1) *See* page 134 *ante*.

Lord Russell of Killowen (read by Lord Porter).—My Lords, the devices resorted to by people who wished to evade liability for Sur-tax were many and ingenious. In 1922 the Finance Act of that year sought to defeat one of those devices. By its 21st Section it was provided that where it appeared to the Special Commissioners that a company, to which the Section applied, had not distributed to its members a reasonable part of its actual income from all sources for any accounting period in such a manner as to render the distributed amount liable to be included in the Sur-tax returns of the members, the Commissioners might direct that, for the purpose of assessment to Sur-tax, the company's income for the period should be deemed to be the income of the members and charged with Sur-tax accordingly.

This provision, however, proved capable of evasion by the expedient of putting the company into liquidation, and maintaining it in that condition. A company in liquidation can make no distribution of its income as such. The provisions of the Finance Act, 1922, Section 21, had no operation in regard to income arising or accruing to a company after the commencement of its liquidation.

This situation was dealt with as regards certain companies to which Section 21 of the Act of 1922 applied, by Section 20 of the Finance Act, 1936. That Section applies to companies which answer the terms of a particular definition, namely, " companies . . . the income whereof consists mainly " of investment income, that is to say, income which, if the company were an " individual, would not be earned income as defined in subsection (3) of " section fourteen of the Income Tax Act, 1918 ". Those companies are referred to in Section 20 of the Act of 1936 as " investment companies ".

The provision of the Section which is relevant to this case is Sub-section (6) (*a*). It runs thus:— " (6) Where, whether before or after the passing of " this Act, an order has been made or a resolution passed for the winding-up of " an investment company to which section twenty-one of the Finance Act, " 1922, applies, the following provisions shall have effect:—(*a*) the actual " income of the company from all sources since the date of the order or " resolution shall, for purposes of assessment to surtax, be deemed to be the " income of the members ".

The question which we have to decide can now be stated. Was the Appellant Company, when it went into liquidation, a company the income whereof consisted mainly of investment income as defined?

I need not repeat the particular facts of this case. It will be sufficient if I recall that the Appellant Company is a company to which Section 21 of the Act of 1922 applies, and that it is conceded that the income which it received in the shape of interest and dividends was investment income as defined. My Lords, I have no hesitation in answering the question in the affirmative.

It was contended on behalf of the Appellant Company that the words " the " income whereof " meant the income as computed for Income Tax purposes, and that, since the trading losses in the fifteen months immediately preceding the liquidation exceeded the investment income received during that period, the income of the Company at the commencement of the liquidation was nil; with the result that the Company did not comply with the terms of the definition, and that therefore Sub-section (6) did not apply to it.

I cannot accede to this argument. I see no reason for assigning this highly technical and artificial meaning to the word " income " in the context in which it occurs. That context is not a taxing provision; it is merely a

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definition clause stating the test which has to be applied for the purpose of ascertaining whether a company is one to which the provisions of the Section are to apply. In a taxing clause one might well expect a reference to income to be a reference to income computed for the purpose of the taxation. That is exactly what is found in Sub-section (6), which is a taxing provision, and which uses the well established phrase " actual income of the company " from all sources ". To my mind the contrast is eloquent and conclusive. Further, the frame of the definition clause indicates to my mind that a comparison is to be made between the company's investment income as defined and the company's other income, with a view to ascertaining whether the investment income as defined does or does not preponderate. I agree with the view expressed by du Parcq, L.J., in the following words: " But, in my opinion, " Section 20, Sub-section (1), of the Finance Act, 1936, requires us to look " not at the aggregate income, but at two categories of income, (1) earned " and (2) everything that is not earned, and to compare them. If under " category (1) we find a loss, and under category (2) a profit, that is for this " purpose immaterial, the object of the Section being to classify a company " according to the character of its income from various sources, and not to " arrive at the true aggregate of its income[1]."

Nor can I agree with another suggestion, namely, that the words " consists " mainly " should be read as meaning " normally consists mainly ". There is nothing to justify us in adding to the provision this notion of normality. Sub-section (6) imposes as a test the existence of a state of affairs at a given point of time, not what was the normal state of affairs over a period of time.

It was contended, however, that the appeal should succeed upon another ground, namely, that before the Commissioners could decide that at the date of the liquidation the Appellant Company was an investment company within the definition, they were bound to consider the state of affairs in relation to the Company's income over a reasonable period of time before the liquidation; that the Commissioners had selected a period of only 15 months which they had treated as conclusive without considering whether or not it was a reasonable period, and that the period so selected was both in fact and in law an unreasonable period.

I see no valid ground for the suggestion that the Commissioners treated the period chosen as conclusive, and omitted to consider whether this period of 15 months was reasonable or not. There is nothing in the Case Stated to justify this allegation of failure in their duty. They rightly treat the question of what is a reasonable period as a question of fact depending on the circumstances of each case, and they accept the Crown's contention that the circumstances of this case are sufficient to bring this Company within the Section. Consider the circumstances in this case. The Company by going into liquidation put an end to its business of buying and selling stocks and shares. It could never again earn any trading income. Nor had it in its last complete financial year before the liquidation earned any trading income. Nor had it earned any trading income in the three months which intervened between the close of its last financial year and the commencement of the liquidation. During all that time its only income consisted of income from investments. In these circumstances it was, in my opinion, reasonable and right to take those 15 months as a period proper to be considered in answering the question whether this Company, when it went into liquidation, was a company the main income whereof consisted mainly of investment income as defined.

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[1] *See* page 140 *ante*.

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In my opinion the Commissioners came to a right decision, and I feel a real difficulty in seeing how a different view can prevail without departing in some way from the words of the Sub-section and substituting a different test from that which it prescribes. The case fits exactly into the words used, if they are read without gloss or addition. The Appellant Company comes under the special provisions of Sub-section (6), not because it was an investment company in the general sense of those words (which it was not), or because of any failure on its part to distribute its income while it was a going concern (which is a matter with which Sub-section (6) has no concern), but because it comes within the statutory definition of what constitutes a company to which (amongst other provisions) the provisions of Sub-section (6) are to apply. The target of that Sub-section is the post-liquidation actual income from all sources of every company which answers the definition in Sub-section (1), and to which Section 21 of the Finance Act, 1922, applies. That income, which would otherwise be payable as capital in the liquidation, is for the purposes of assessment to Sur-tax to be deemed to be the income of the members.

I agree with the judgments of Macnaghten, J., and Goddard and du Parcq, L.JJ., and would dismiss this appeal.

Lord Porter.—My Lords, this case involves two complicated and difficult points of law, but in the end the result depends upon the true construction of Section 20 of the Finance Act, 1936. Sub-section (1) of that Section is worded as follows:— " The following provisions of this section shall have " effect as respects companies (hereafter in this section referred to as ' invest- " ' ment companies ') the income whereof consists mainly of investment " income, that is to say, income which, if the company were an individual, " would not be earned income as defined in subsection (3) of section fourteen " of the Income Tax Act, 1918 ".

The sole question in the case is whether the Appellant Company is an investment company as so defined, and two points are taken on its behalf. It is said that:— (i) Considering all the circumstances its income did not at the material time or times consist mainly of investment income, i.e., of income which in the case of an individual would be classified as unearned. (ii) In fact it had at the material time no means at all, and therefore it could not be said that its income consisted mainly of anything.

The ultimate question is the same in either case, namely, whether the Appellant is an investment company, but the approach is different. In order to determine the first point, it must be accepted that there is an income, and one must then discover of what it consists at the material time. The important factor is to ascertain what is the material time, and what (if any) period must be taken into consideration in deciding whether the income is or is not mainly investment income.

In order to determine the second, it has to be conceded that the moment of time at which one must look to discover of what the income consists is either the moment of liquidation or that taken by the Commissioners, namely, the last year and three months. Admittedly the Company's income up to that time was not mainly investment income. Thereafter the loss incurred in its trading greatly exceeded any sums derived from the interest and dividends on its holding of stocks and shares, and accordingly it claimed and obtained repayment of the tax deducted from them. The result, therefore, was that if the Company's income be regarded as consisting of the combined product of its trading activities and of the sums received as interest and

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dividends on its stocks and shares, it had made a loss and not a profit in respect of the last fifteen months of its life before going into liquidation.

I propose, with your Lordships' permission, to deal with the two questions in the order in which I have stated them but, as will appear, I find it unnecessary, having regard to my view upon the former, to come to any conclusion upon the latter.

(i) In order that the Section may apply, the income of the company must consist mainly of investment income.

If it has to be ascertained whether income is mainly investment or non-investment income, the income referred to must be capable of including both. Both must be taken into consideration and the one compared with the other, but there still remains to be decided the time at which and the period over which that comparison has to be made.

Was, then, this Company's income mainly investment income? Undoubtedly at the moment at which the liquidation began it was investment income, and it was urged upon us that we should look neither forward nor backward but only at that moment. Indeed it was contended that if at that moment a company had ceased to do profitable business even for a short time and held no investments except Government stock, the income of which accrued *de die in diem,* its only relevant income was that derived from the Government stock. Neither the past nor the future must be looked at; the only question was whether there was any other income at the moment of liquidation.

Alternatively, it was said, you must take the income of the preceding year of assessment or such further time as, in the opinion of the Commissioners, gives a true picture of the source from which the company's income is derived.

The difficulty of the first suggestion is that it takes account only of income accruing from moment to moment and disregards even that which would normally be earned by the investments which the company holds. If, for example, the illustration given in argument for the Respondents is varied and the company be supposed to hold, not Government stock, but shares upon which no dividend had been declared, the company's income would be nil, with the result that, however long it had ceased to trade and however large its holding of shares, it would not be an investment company as defined in the Section. I cannot think that this is correct or that its members would escape liability for tax upon this assumption. The second contention can perhaps best be dealt with by taking the suggestion most favourable to the Respondents, namely, that the period to be considered being a question of fact and the Commissioners having determined as a question of fact that the preceding full year and the succeeding broken quarter were the proper period, your Lordships would not interfere with their finding.

No doubt when a company goes into liquidation the circumstances may be such that it is proper to have regard to a short period only of its previous activities, and if I saw any ground for distinguishing between the period before the 1st January, 1937, and that after that date, I should think the decision of the Commissioners ought not to be disturbed; but I see no facts upon which such a distinction could be drawn. As I read paragraphs 9 and 10 of the Case, the Commissioners accept the argument that the fact that for the 15 months before the Company went into liquidation the Appellant had been drawing an income from investments only was conclusive of the case. The previous history of the Company, or the fact that it continued to trade until the last moment, did not weigh with them, nor in their view need those

facts be taken into consideration. It was enough that for 15 months it had no other income.

I do not accept this view. In every case I think that the activities of the company as a whole must be looked at. Of course, if it be found that there has been a definite change in the type of business carried on, or in the method of carrying it on, so that the income of the company is thereafter derived mainly or entirely either from investment or from non-investment income as the case may be, consideration of the previous earnings of the company may be ruled out. But in the present case until liquidation there was no such change. The Company continued to carry on its dealings in stocks and shares as before.

It is suggested that in taking this view one is answering the question: Of what does the company's business consist, not of what does its income consist? whereas the Act poses the latter and not the former question. If the position at the moment of winding up is alone to be regarded, such a criticism is justified, but unless one adopts that view some period of time must be taken into consideration, and I can see no reason for confining the enquiry to the company's income during the previous year or 15 months. The Section does not say of what does the income consist having regard to the position during the previous completed Income Tax year, or during that period and any broken period thereafter. It enquires simply of what does the major portion of the income consist, and that, I think, obliges one to look at the income as a whole, subject, of course, as I have said, to any change of business in the course of the company's career. So regarded the income of this Company mainly consists of non-investment income. The Company's activities were directed to earning profits from its dealings in stocks and shares, and not, except incidentally, to deriving income from the interest and dividends of the stocks and shares in which it dealt. It is true that only eight years' results have been taken for the purpose of enabling a judgment to be formed as to what is the main income of the Company, but that appears to be the period selected by the parties as representative of its income during the whole of its existence if that be the material period. At any rate the Respondents have not suggested that they are discontented with it or that any further information would change the result. In their submission, however representative the eight years may be, the Commissioners should not have looked, or at any rate were not obliged to look, at any period beyond the last 15 months.

If the Section applied only to companies in liquidation there would be greater force in this argument, since it might be said that the income referred to was that which the company was actually receiving at the moment of liquidation and possibly to interest and dividends receivable thereafter, since these latter are income in the hands of the company and recognised as such by Sub-section (6), though they are distributable as capital to its members in the liquidation.

But the Section does not apply solely to a company which is in liquidation. Sub-sections (2) to (5) inclusive, are concerned with companies which continue to carry on business, and it is not until Sub-section (6) is reached that liquidation is mentioned. The chameleon-like quality which might be imparted to a living company in changing from year to year from an investment to a non-investment company or *vice versa* is, to my mind, at least an odd result of the Crown's contention.

The Section defines an investment company, and where the question arises the proper tribunal has to determine whether a particular company comes within the definition or not. The answer, it is true, depends upon

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whether one type of income preponderates or not, but not necessarily upon whether that type preponderates at a particular moment of time or over a particular period. I prefer to look at the company as having a continuing character and to ask: Of what does the income of that company consist, having regard to its whole life or such portion of that life as truly represents its character?

The income is that of a living entity and should, I think, be representative of its receipts in general and not of those which arise or accrue at a particular point of time or (subject to what I have said about a general change in its methods of business) over part only of its existence. The enquiry as to what its income consists of must be answered with that fact in view, and is, I think, correctly answered in the present case by saying that it mainly consists of non-investment income.

Having regard to my view as to the first point, I do not think it necessary to express any opinion on the second, and I must not be taken as having formed any opinion upon it. It will be open to argument in any future case where it comes in issue.

I am of opinion that the appeal should be allowed.

Questions put:

That the Order appealed from be reversed.

The Contents have it.

That the Cause be remitted to the Commissioners for the Special Purposes of the Income Tax Acts, with a declaration that the Company was not at the material time an investment company within the meaning of Section 20 (1) of the Finance Act, 1936, and with a direction to discharge the direction made by them under the provisions of Section 21 of the Finance Act, 1922, as extended by the provisions of Section 20 of the Finance Act, 1936, and that the Respondents do pay to the Appellants their costs here and below.

The Contents have it.

[Solicitors :—Birkbeck, Julius, Edwards & Co.; Solicitor of Inland Revenue.]

(70700) Wt. 4329/4 5/45. Hw. G.383.