WILLIAMS'S EXECUTORS *v.* COMMISSIONERS OF INLAND REVENUE

No. 1282—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—18TH, 19TH AND 22ND MAY, 1942

COURT OF APPEAL—15TH, 16TH AND 17TH FEBRUARY, 1943

HOUSE OF LORDS—28TH AND 29TH FEBRUARY, 1944

(1) COMMISSIONERS OF INLAND REVENUE *v.* WILLIAMS'S EXECUTORS(1)

(2) WILLIAMS'S EXECUTORS *v.* COMMISSIONERS OF INLAND REVENUE(2)

Sur-tax—Total income—Capital or income.

At a general meeting in 1922 *of a private company dealing in bloodstock, it was resolved that all reserve funds (which consisted entirely of undistributed profits of the company) should be the joint property of members of the company pro rata to their shareholdings. In* 1927, *W became a director of the company, acquiring* 750 *shares out of the* 3,000 *issued and paying* £1,901 10s. *for a one-fourth share of the reserve fund. In view of the value of their personal connexions, each director took out an insurance policy against death or disablement by accident; the company paid the premiums and was the beneficiary under the policies. In February,* 1938, *one of the directors died as the result of an accident and the company received* £15,000 *from the insurance company.*

At the annual general meeting of the company held on 31*st May,* 1938, *it was resolved that this sum of* £15,000, *and a sum of* £5,000 *taken from the reserve fund, should be distributed. Of these amounts, W received respectively* £2,750 *and* £1,250, *which were included in an assessment to Sur-tax made upon his Executors for the year* 1938–39. *The Executors appealed against the assessment, contending that both sums were in the nature of capital. The Special Commissioners held* (1) *that the insurance policies were taken out to provide against damage or loss of a capital nature and the sum received thereunder was a distribution of capital; and* (2) *that W had acquired by his payment of* £1,901 10s. *an interest in the reserve fund carrying with it the right to participate in an income distribution, and that the sum received formed part of his income for Sur-tax purposes.*

Held,

(a) *in the King's Bench Division, that the distribution of* £5,000 *out of the reserve fund was a dividend out of the company's profits and, accordingly, the amount of* £1,250 *received by W was income in his hands for tax purposes;*

(b) *in the House of Lords, affirming the decisions of the Courts below, that the sum received by the company under the insurance policy was a revenue receipt, and W's share thereof had been correctly included in the assessment to Sur-tax.*

(1) Reported (K.B.) 167 L.T. 272; (C.A.) 168 L.T. 195; (H.L.) 60 T.L.R. 255.

(2) Reported (K.B.) 167 L.T. 272.

CASES

(1) *Commissioners of Inland Revenue* v. *Williams's Executors*

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 21st March, 1941, the Executors of D. H. Williams, deceased (hereinafter called " the Respondents "), appealed against an assessment to Sur-tax made upon them for the year 1938–39 in the sum of £9,790.

2. There were two questions for our determination, one of which forms the subject-matter of a separate Case, *Williams's Executors* v. *Commissioners of Inland Revenue,* which follows hereon. The question to which alone the present Case relates is whether the proceeds of an insurance policy taken out against the death by accident of a director of a company called British Bloodstock Agency, Ltd. were income or capital in the hands of the said company, and whether, therefore, the aforesaid proceeds when distributed were income or capital in the hands of the recipients, one of whom was Mr. D. H. Williams.

3. British Bloodstock Agency, Ltd. (hereinafter referred to as " the " company ") was incorporated as a private limited company on 24th November, 1911. A copy of the memorandum and articles of association is annexed hereto, marked " A ", and forms part of this Case(1).

The company's business is the buying and selling of bloodstock and, to a certain extent, the keeping of bloodstock.

4. The nominal and issued capital of the company is £3,000 divided into 3,000 shares of £1. Originally there were three shareholders, E. E. Coussell, E. Moorhouse and R. Bunsow, each holding 1,000 shares and all three being directors of the company. Mr. Bunsow went out of the company at an early stage, his shares being divided equally between the two remaining directors, who thus held 1,500 shares each.

5. By article 14 of the articles of association a quorum of two sufficed for a general meeting. It was not necessary to send a copy of the directors' report and accounts to the shareholders. All business decided to be special was to be dealt with at an extraordinary meeting. The company in general meeting could declare dividends, but not exceeding what was recommended by the directors.

6. At a general meeting held on 21st April, 1922, a resolution was passed in the following terms:—

> " Resolved that all reserve funds or working capital (all of which is " undistributed profits of the Company) together with undistributed " balance of Revenue Account, whether invested in or outside the busi- " ness of the Company, shall be the joint property of the present " members of the Company, pro rata to their share holdings in the " Company, and that in the event of the death or retirement from the " Company of a member, such proportions of the above-mentioned " balance shall be paid to the retiring member, or to the legal personal " representative of the deceased member, by the remaining or surviving " members."

(1) Not included in the present print.

At the date of this resolution the reserve fund stood at about £3,000. Since then it has been steadily increased by transfers from revenue account.

In consequence of this resolution all reserve funds and undistributed profits of the company were regarded as the joint property of the then members of the company, Mr. Coussell and Mr. Moorhouse, and were treated as credited to the two members' capital accounts, as though they were partners.

7. On 31st March, 1925, Mr. Moorhouse retired, and on 1st April, John Crawford became a member and director of the company. Mr. Crawford acquired the 1,500 shares which had been held by Mr. Moorhouse at a price of £3 per share. At this time the company's reserve fund stood at about £4,000, and Mr. Crawford paid £2,000 to Mr. Moorhouse in addition to the sum of £4,500 for the shares. He could therefore be regarded as Mr. Moorhouse's assignee in respect of his share of the reserve fund.

8. The reserve fund gradually increased and on 14th April, 1927, it stood at £7,606. On that date D. H. Williams became a member and director of the company. Mr. Williams acquired 750 shares, being one-fourth of the total number of shares, half from Mr. Coussell and half from Mr. Crawford, at a price of £6 per share. At the same time he paid to these two directors a sum of £1,901 10*s*., being one-fourth of the amount at which the reserve fund stood. All three individuals treated the reserve fund as being capable of assignment.

9. On 1st September, 1928, when the shares were worth about £3 each, Mr. Coussell and Mr. Crawford each transferred 50 shares to a Mr. F. L. Birch and 25 shares to a Miss E. Chambers, these two individuals having been members of the company's staff for some 15 or 16 years.

Thus from this date the shares were held as follows:—

Mr. Coussell	...	...	1,050
Mr. Crawford	...	...	1,050
Mr. Williams	...	...	750
Mr. Birch	...	...	100
Miss Chambers	...	...	50

At a later date, in 1934, Mr. Coussell and Mr. Crawford wrote to Mr. Birch and Miss Chambers making it clear that they were not entitled to any share of the reserve fund or bonuses that had accumulated up to 1st September, 1928, when their shares had been transferred to them. They were entitled from that date not only to the shares but to future dividends and bonuses.

10. In 1933 an insurance against accident to Mr. Crawford was, for the first time, taken out for a sum of £15,000 on death, and certain lesser sums in the event of partial or total disablement, etc. The policy contained a number of endorsements, of which the one relevant to the appeal was that the company was to be recognised as the beneficiary in the event of any claim arising out of the policy. A photostatic copy of the policy and endorsements is annexed hereto, marked " B ", and forms part of this Case(1) The policy was renewed from year to year, the company paying the premiums

11. On 1st February, 1938, Mr. Crawford died as the result of an accident in South Africa.

In due course the sum of £15,000 was paid to the company by the insurance company, and was distributed by the company, as hereinafter appearing, to Mr. Coussell, the executors of Mr. Crawford, and Mr. Williams.

(1) Not included in the present print.

The appeal before us brought by the Executors of D. H. Williams, deceased, was concerned with the question of liability to Sur-tax in respect of this distribution of policy moneys as affecting Mr. Williams. Mr. Williams died on 8th April, 1939.

12. The company was assessed to National Defence Contribution for the period to 31st March, 1938, and to Income Tax for the year 1938–39 by reference to the receipt of the said sum of £15,000. At first the company disputed liability on the ground that the said sum was a capital receipt but later withdrew its objection and accepted liability.

13. Evidence was given before us by Mr. Coussell who founded the business of the company and has been a director and secretary throughout. Mr. Coussell is the Respondent in a further case, in which precisely the same point is at issue.

Mr. Coussell stated that Mr. Crawford was of special value to the company. Mr. Crawford, whom he had known since 1914, had been the company's agent in Bombay before he joined the company in 1925. He had valuable connections in India where, after the South African war (during which he had been a Captain in the Army Veterinary Corps), he became the leading veterinary surgeon in India, and the judge of the Turf Club, Bombay. He was the pioneer of high breeding in India, and was very prominent there for twenty years, becoming an acquaintance and friend of a number of Maharajahs. He had also valuable connections in South Africa, Australia and New Zealand.

Mr. Crawford proposed the idea of his life being insured against accident (which was first done in 1933) as he was travelling annually on the company's business to different parts of the world. He suggested that in the event of his death the company's business would suffer and his family would not get much for his shares. The object of the insurance was not to cover any temporary loss.

Mr. Crawford suggested that he, the witness, should also be insured for a capital sum of £15,000, but he decided that £10,000 was sufficient, and his life was insured against accident for that amount.

Mr. Williams, who had connections in Ceylon and who travelled there as well as in India and the Far East as the company's representative, was similarly insured for a sum of £10,000. Similar insurances have been affected in respect of the present directors of the company.

The premiums on the directors' policies were charged to the company's accounts as directors' expenses. The company paid all the premiums until Mr. Crawford's death.

A policy was also taken out on the stud manager's life and the premium was charged in the company's accounts as an ordinary trading expense. All the above-mentioned policies were endorsed to the effect that the company was the beneficiary.

The company employed a number of grooms, who travelled with the horses when they were shipped abroad, and the company took out policies on their lives to cover each journey, but in these cases the beneficiaries were not the company but the grooms' relatives.

The whole of the £15,000 policy moneys received on Mr. Crawford's death was, under the terms of a resolution passed at the company's annual meeting on 31st May, 1938, distributed between Mr. Crawford's executors, Mr. Williams and himself in proportion to their shareholdings. (A copy of the minutes of this annual meeting is annexed hereto, marked " C ", and

(1) Not included in the present print.

forms part of this Case(1)). The two employees, Mr. Birch and Miss Chambers (who hold 100 and 50 shares, respectively), did not receive anything in this distribution. They were taken care of by a separate provision, as it was thought better to make the distribution to the principal shareholders only. This might have been irregular, but, if so, it was an honest irregularity. The two employees were satisfied with the arrangements made for them. They understood the position and agreed to it. There was oral notice of the annual meeting and the two employees were actually present, although the fact of their presence was not recorded in the minutes. They did not vote at the meeting.

14. Copies are annexed hereto of the company's accounts for the years to the 31st March, 1938, and 31st March, 1939. They are marked "D" and "E", respectively, and form part of this Case(1).

In the balance sheet for the year to 31st March, 1938, appears an item under the heading "Reserve Account", "Compensation received from "Insurance Company through death by accident Mr. J. Crawford, £15,000." In the balance sheet for the year to 31st March, 1939, this item appears under the heading "Compensation received from Insurance Company", set off by payments of the full amount of £15,000 "to the account of Gilchrist, "Williams and Coussell, 31/5/38 Minute."

15. It was contended on behalf of the Respondents that the policy moneys were a capital and not a trading receipt in the hands of the company, and were received as a distribution of capital by the three principal shareholders, of whom Mr. Williams had been one. The case was distinguishable from that of *Gray & Co., Ltd.* v. *Murphy* (23 T.C. 225), and alternatively, if it could not be distinguished, *Gray & Co., Ltd.* v. *Murphy* has been wrongly decided.

16. It was contended on behalf of the Crown that the policy moneys were a trading receipt of an income nature in the hands of the company, and were received as a distribution of income by the said shareholders, including Mr. Williams. In support of this contention the Crown relied chiefly on *Gray & Co., Ltd.* v. *Murphy*.

17. We, the Commissioners who heard the appeal, gave our decision in the following terms:—

"We think this case is to be distinguished on its facts from *Gray & Co.,* "*Ltd.* v. *Murphy* (23 T.C. 225). In the latter case accident policies were "taken out in order to put the company in funds for meeting obligations "which it might incur in the course of its business by reason of accidents to "employees who were not covered by workmen's compensation indemnity "policies. In the present case the accident policy we have to consider is "one of three such policies against accidents to the directors of the company "concerned. The prosperity of the company depended on the personal "qualities and experience of the directors, and a fatal or disabling accident, "particularly in the case of Mr. Crawford whose qualifications and connections were of special value, would cause the company's business to suffer "seriously. Moreover, while the company, as a distinct entity, was the "beneficiary under the policies, it is relevant to the purpose of the policies "that the directors, who held all or practically all the shares, closely identified themselves with the company, very much as if they were partners in "a firm, and were concerned with the prospect of loss to themselves or their

(1) Not included in the present print.

" families. In these circumstances we hold that the policies were taken " out to provide against damage or loss of a capital nature, and not, as in " *Gray & Co., Ltd.* v. *Murphy* (23 T.C. 225), against liabilities of a revenue " nature, and correspondingly that the sums received by the Appellants were " received as distributions of capital, not forming part of their income for " purposes of Sur-tax."

18. On the figures being agreed on the basis of the above decision, and also of our decision on a different issue the subject-matter of a separate Case which follows hereon, we reduced the assessment on the Respondents to the sum of £4,040.

19. The Appellants immediately after the determination of the appeal declared to us their 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.

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

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

17th November, 1941.

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(2) *Williams's Executors* v. *Commissioners of Inland Revenue*

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 21st March, 1941, the Executors of D. H. Williams, deceased (hereinafter called " the Appellants "), appealed against an assessment to Sur-tax made upon them for the year 1938–39 in the sum of £9,790.

2. There were two questions for our determination, one of which forms the subject-matter of the foregoing Case, *Commissioners of Inland Revenue* v. *Williams's Executors*. The question to which alone the present appeal relates is whether certain sums distributed from reserve account to members of British Bloodstock Agency, Ltd. (hereinafter referred to as " the company ") were income or capital in the hands of the recipients, one of whom was D. H. Williams.

3. The facts relevant to the present appeal include those set out in paragraphs 3 to 9 of the foregoing Case.

The facts particularly relating to the company's reserve fund are set out in paragraphs 6 to 8 of the foregoing Case. Paragraph 8 records that by 14th April, 1927, the reserve fund, which had gradually increased, stood at £7,606, and continues as follows: " On that date D. H. Williams became a " member and director of the company. Mr. Williams acquired 750 shares, " being one-fourth of the total number of shares, half from Mr. Coussell and

" half from Mr. Crawford " (the two individuals who before the transaction held 1,500 shares each and were the only directors) " at a price of £6 per " share. At the same time he paid to these two directors a sum of " £1,901 10*s*., being one-fourth of the amount at which the reserve fund stood. " All three individuals treated the reserve fund as being capable of " assignment."

4. At a directors' meeting held on 31st May, 1938, it was resolved: " That " steps should be taken as soon as possible for the purpose of giving effect " to a reduction of the Reserve Fund Account from £13,000 " (at which it then stood) " to £8,000 and that the balance of £5,000 should be distributed " pro rata among the shareholders registered in the Company's books on the " 31st March, 1938. It was decided the necessary Resolution should be put " forward at the Annual General Meeting of the Company." A copy of the minutes of this meeting is annexed hereto, marked " A ", and forms part of this Case(1).

At the annual general meeting of the company held on the same day it was resolved, *inter alia*, that the said sum of £5,000 should be distributed and allocated as follows:—

£1,875 to Mr. Coussell.
£1,875 to executors of J. Crawford (who died on 1st February, 1938).
£1,250 to Mr. Williams.

A copy of the minutes of this meeting is annexed hereto, marked " B ", and forms part of this Case(1).

5. It was contended on behalf of the Appellants that Mr. Williams by his payment of £1,901 10*s*. acquired certain rights in the reserve fund, which were independent of his shareholding in the company, and that when he received £1,250 on account of those rights under the resolution of 31st May, 1938, what he received was in the nature of capital.

6. It was contended on behalf of the Crown that the £1,250 received by Mr. Williams under the said resolution was received by him by reason of his ordinary rights as a shareholder, and represented the distribution of profits of the company as a dividend.

7. We, the Commissioners who heard the appeal, gave our decision in the following terms:—

" As regards the distribution from reserve account, after considering " the facts and the arguments addressed to us, we have come to the " conclusion that what Mr. Williams acquired by his payment of " £1,901 10*s*. on joining the company was an interest in the reserve fund " carrying with it the right to participate in an income distribution there- " from. We hold that the sum received by Mr. Williams under the " resolution of 31st May, 1938, no less than that received by Mr. Coussell, " an original shareholder, was received as income and formed part of " his income for Sur-tax purposes."

8. On the figures being agreed on the basis of the above decision, and also of our decision on the different issue forming the subject-matter of the foregoing Case, we reduced the assessment on the Appellants to the sum of £4,040.

9. The Appellants immediately after the determination of the appeal declared to us their 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

(1) Not included in the present print.

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.

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

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

17th November, 1941.

The cases came before Macnaghten, J., in the King's Bench Division on 18th and 19th May, 1942, when judgment was reserved. On 22nd May, 1942, judgment was given in favour of the Crown in each case, with costs.

The Attorney-General (Sir Donald Somervell, K.C.) and Mr. Reginald P. Hills appeared as Counsel for the Crown, and Mr. J. Norman Daynes, K.C., and Mr. J. S. Scrimgeour for the Executors.

JUDGMENT

Macnaghten, J.—These appeals relate to the assessment to Sur-tax made upon the Executors of the late Mr. D. H. Williams for the year 1938-39, in the sum of £9,790. Against that assessment the Executors appealed to the Special Commissioners, who reduced it to £4,040. Both the Crown and the Executors were dissatisfied with that decision as being erroneous in point of law, and they each required the Special Commissioners to state a Case for the opinion of this Court.

For the Crown it is said that the reduced assessment should be increased by the sum of £2,750, while the Executors contend that it should be further reduced by £1,250.

The facts giving rise to these contentions are as follows. In 1911 three gentlemen, Mr. Coussell, Mr. Moorhouse and Mr. Bunsow, formed a company called British Bloodstock Agency, Ltd., as a private company, limited by shares, with a capital of £3,000 divided into 3,000 shares of £1 each. They each took 1,000 shares and they all three were directors of the company. A few years later Mr. Bunsow retired from the company; he transferred half of his shares to Mr. Coussell and half to Mr. Moorhouse, who thus held 1,500 shares each. The following resolution was passed on 21st April, 1922, at what is described as a general meeting of the company, namely: " Resolved " that all reserve funds or working capital (all of which is undistributed " profits of the Company) together with undistributed balance of Revenue " Account, whether invested in or outside the business of the Company, shall " be the joint property of the present members of the Company, pro rata " to their share holdings in the Company, and that in the event of the death " or retirement from the Company of a member, such proportions of the " above-mentioned balance shall be paid to the retiring member, or to the legal " personal representative of the deceased member, by the remaining or sur- " viving members."

In dealing with the appeal of the Executors it will be necessary to consider the meaning and effect, if any, of that resolution; but it has no bearing on the question at issue in the appeal by the Crown.

(Macnaghten, J.)

On 31st March, 1925, Mr. Moorhouse retired from the company; he sold his 1,500 shares to Captain John Crawford at the price of £3 per share. At that date the reserve fund, consisting as it did of undistributed profits, stood at about £4,000; Captain Crawford paid to Mr. Moorhouse £2,000 in addition to the £4,500 which he paid for the shares.

On 14th April, 1927, the late Mr. D. H. Williams acquired 750 shares, that is, a quarter of the share capital of the company. He bought 375 shares from Mr. Coussell and 375 shares from Captain Crawford at the price of £6 per share. At that date the reserve fund stood at £7,606, and Mr. Williams paid to Mr. Coussell and Captain Crawford one-fourth of that sum, £1,901 10*s.* 0*d.*, in addition to the £4,500 which he paid for the 750 shares.

Captain Crawford, according to the evidence given by Mr. Coussell before the Special Commissioners, was a person of special value to the company. He had been the company's agent in Bombay before he became a shareholder in 1925. He had valuable connections in India, where he became the leading veterinary surgeon and the judge of the Turf Club at Bombay. He was the pioneer of high breeding in India, and a friend of a number of Maharajahs.

Captain Crawford used to travel every year to different parts of the world on the company's business, and in 1933 he suggested to Mr. Coussell and Mr. Williams that, since the company's business would suffer loss in the event of his death, it would be advisable to effect a policy of insurance against his death by accident. This suggestion was approved by them, and accordingly a policy of insurance for one year, described as a "Personal Accident Policy", was taken out by Captain Crawford with the Car & General Insurance Corporation, Ltd., dated 30th May, 1933. The company paid the premiums on the policy which bore the endorsement that in the event of any claim arising under it, the insurance company would recognise the British Bloodstock Agency, Ltd. as the beneficiaries. The policy provided that in the case of the death of Captain Crawford by accident the insurance company would pay £15,000, and that in the case of his temporary total disablement from attending to business, compensation at the rate of £50 per week would be paid for a period of not more than 52 weeks. The policy was renewed from year to year, the company paying the premiums. On 1st February, 1938, Captain Crawford died as the result of an accident in South Africa, and in due course the British Bloodstock Agency, Ltd. received £15,000 from the insurance company.

At the annual general meeting of the company held on 31st May, 1938, it was resolved that a dividend of 150 per cent., free of tax, should be paid on the ordinary shares for the year ending 31st March, 1938, and that the sum of £15,000 received from the insurance company should be distributed as follows: £4,125 to Mr. Coussell, a like sum to the executors of Captain Crawford, £2,750 to Mr. D. H. Williams, and £4,000 to an account at the Westminster Bank in the names of Williams, Gilchrist and Coussell.

Mr. D. H. Williams, who died on 8th April, 1939, received his share, £2,750, during the tax year 1938-39; and the question at issue is whether it should be included in his assessment to Sur-tax for that year. In the assessment of the company to Income Tax the £15,000 paid by the insurance company was treated as an income receipt, and the taxable income of the company was thereby increased by that amount. It was claimed by the Crown that the £2,750 ought to be included in his assessment to Sur-tax for the year 1938-39. His Executors, on the other hand, contended that it was

(Macnaghten, J.)

a capital and not an income receipt and ought to be excluded from his Sur-tax assessment. The Special Commissioners upheld the contention of the Executors and excluded the £2,750 from the Sur-tax assessment of their testator.

It is admitted that the company had an insurable interest in the life of Captain Crawford; and, though Mr. Coussell gave evidence that the object of the insurance was not to cover any temporary loss, the policy made provision for the payment of compensation at the rate of £50 per week in the case of the temporary disablement by accident of Captain Crawford.

If the policy had been merely a policy for compensation in the case of the temporary disablement of Captain Crawford, it would seem clear that the money received by the company in such a case would be an income receipt; and the question arises whether in the case of the death of Captain Crawford the same consequence should follow. The question is similar to, though not quite the same, as that which arose in the case of *Gray & Co., Ltd.* v. *Murphy*, 23 T.C. 225. I respectfully agree with the observation made by the late Lord Buckmaster that in considering whether a particular receipt or a particular payment ought to be regarded as an income receipt or an income payment, decisions of the Court in previous cases are not of any great assistance. But I think the case of *B. W. Noble, Ltd.* v. *Mitchell*, 11 T.C. 372, does afford useful guidance in the case before me. In that case the directors of a company were anxious that one of their number, who held his appointment for life, should retire from the board. Their view was that it would be for the benefit of the company that he should do so; and, since the company was formed for the purpose of carrying on business for profit, it is to be presumed that they thought that the company would gain by his retirement. After considerable negotiation the director was induced to resign in consideration of the payment of £19,200 payable in five annual instalments. The sum so paid covered certain other matters besides the resignation of the director, but these other matters were obviously of minor importance; the resignation of the director was the main consideration moving from him and was so regarded by the Court. The question arose whether the annual instalments should be treated as income payments to be debited to the trading account of the company. It was held by Rowlatt, J., and the Court of Appeal that they should be so treated. In the Court of Appeal Sargant, L.J., said: "Then comes the next point: whether this very large "payment was a payment which was so exceptional in its nature that it "must be considered as a capital payment and not a payment by way of "deduction from annual outgoings. With regard to that, I entirely agree with "the view of the learned Judge, that the dismissal of a servant, or compen-"sation paid to ensure the dismissal of a servant (which, of course, this "director was—a servant of the Company) is a payment which would in the "ordinary course be attributed to the year in which the payment was made, "and I see no reason for thinking in this case that it was of the nature of a "capital expenditure."(1)

If a sum paid to induce the resignation of a director, whose continuance in office would be detrimental to the company, is to be regarded as an income expense, a sum received as compensation for the loss of the services of a director, whose continuance in office would have been of value to the company, must, I think, likewise be regarded as an income receipt.

(1) 11 T.C., at p. 422.

(Macnaghten, J.)

I think, therefore, that the decision of the Special Commissioners in this matter was erroneous, and the Sur-tax assessment made for the year 1938-39 on the Executors of Mr. D. H. Williams should include the £2,750 which he received.

As to the Executors' claim that the assessment should be reduced by £1,250: At the annual general meeting held on 31st May, 1938, it was also resolved that a sum of £5,000 should be taken from the reserve account (which then stood at £13,000), and be distributed amongst the two directors, Mr. Coussell and Mr. Williams, and the executors of the late Captain Crawford. Mr. Coussell and the executors of Captain Crawford received three-fourths, £3,750, and Mr. Douglas H. Williams received one-fourth, £1,250, of the £5,000. It was argued on behalf of the Executors that the effect of the resolution of 21st April, 1922, was that the amount standing to the credit of the reserve fund became a debt due to the members of the company, which would become payable to them, if and when they should resolve to distribute it amongst themselves. In my view the resolution is wholly inoperative. It is only another instance of the pitfalls that await persons who make use of the Companies Acts for a purpose very different from that which those who framed the Companies Act, 1862, ever contemplated. In 1922 when the resolution was passed, the only members of the company were Mr. Coussell and Mr. Moorhouse. They held all the shares of the company between them, 1,500 each, and no doubt they regarded themselves as partners. If they had been partners, this resolution would have been effective as between themselves; but in the case of a company limited by shares, such a resolution is obviously incompetent, if it was intended thereby to capitalise the undistributed profits and provide for their distribution as capital. A company limited by shares is entitled to distribute its profits by way of dividend, but it cannot distribute its capital. Since the reserve account of £13,000 consisted of undistributed profits, the resolution of 31st May, 1938, to the effect that £5,000 should be taken from it and distributed in the way I have mentioned, was perfectly valid as a resolution for the distribution of a dividend out of profits, but was of no validity otherwise.

In my opinion, therefore, the decision of the Special Commissioners was right, and the sum of £1,250 received by Mr. Williams must be included in his assessment to Sur-tax for the year 1938-39.

In my view the appeal of the Crown succeeds, and the appeal by the Executors fails.

Mr. Hills.—Then the appeal of the Crown will be allowed with costs, and my learned friend's appeal dismissed with costs, my Lord?

Macnaghten, J.—Yes.

An appeal having been entered against the decision in the King's Bench Division in the first case, on the question of the amount of £2,750 received under the insurance policy, the case came before the Court of Appeal (Lord Greene, M.R., and Scott and MacKinnon, L.JJ.) on 15th, 16th and 17th February, 1943, and on the last-named date judgment was given unanimously in favour of the Crown, with costs, confirming the decision of the Court below.

Mr. J. Norman Daynes, K.C., and Mr. J. S. Scrimgeour appeared as Counsel for the Executors, and the Attorney-General (Sir Donald Somervell, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Lord Greene, M.R.—It is conceded in this appeal that if the sum in question was not of a nature to attract Income Tax in the hands of the company it cannot be taxed in the hands of the shareholder, whose Executors are the Appellants, either for Income Tax or for Sur-tax. The sole question, therefore, which we have to consider is whether or not this sum was in the hands of the company a receipt on capital account or a receipt on revenue account. The fact that the company has agreed to have it treated as between itself and the Revenue as a receipt on revenue account cannot bind the present Appellants, who are not affected by the view which the company may have taken.

The difficulty lies, as it does so often, in the application of principles to the facts of an individual case; and in this class of case, different minds may well take different views. I have come to the conclusion that the decision of Macnaghten, J., was right.

The first thing to do is to examine the nature of the payment which the company received. It was a sum of £15,000 received under a policy taken out for the benefit of the company covering injury or death by accident of Mr. Crawford, one of the directors of the company. It was a very small company. There were three principal shareholders and directors, and Mr. Crawford was a gentleman who had very special experience and knowledge of bloodstock, with the sale and purchase of which the company's business was mainly concerned. The nature of his special value to the company is set out in the Stated Case, and I need not read the passages which refer to it.

The company adopted the policy of effecting insurances of a similar character in respect of Mr. Crawford, also in respect of the other two directors, who, in different ways, appear to have had qualifications and experience of special value to the company. But Mr. Crawford obviously stood in a category by himself. The object of the insurance was not to cover any temporary loss. That is stated in the Case, although when one comes to look at the policy it is not quite clear how that conclusion was reached by the Special Commissioners. But the suggestion out of which the insurance materialised was that, in the event of Mr. Crawford's death, the company's business would suffer and his family would not get much for his shares. The latter part of that sentence does not seem to alter the real character and object of this insurance, which was quite clearly to give the company some money to make up for the loss which it would suffer if it were deprived of the very valuable services of Mr. Crawford.

It is clear from the Stated Case that Mr. Crawford was not bound to the company by any contract. He could have severed his connection with it, or he could have ceased to perform the very useful services which he was performing. But that, to my mind, does not affect the matter. From the business point of view Mr. Crawford's connection with the company was one which obviously was likely to endure, and the absence of any contract of service binding him to the company does not alter the business position, which was that, so long as he remained there, he would naturally continue to do what he had done in the past and give the company the benefit of his great experience. The case, therefore, may be treated, it seems to me, in exactly the same way as a case in which a valuable servant is bound by a contract, long or short, and the benefit of his services is protected, so to speak, by a policy of insurance taken out by the employer.

The policy contained what is called a " Compensation Schedule ", and it is, on the face of it, perhaps more appropriate to a policy designed to

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compensate an individual in respect of injury by accident. But that was not the object of this policy; it was not a policy such as that dealt with in the case of *Gray & Co., Ltd.* v. *Murphy*, 23 T.C. 225. The object of the policy in that case was to put the company in funds in respect of payments to employees which, either through a legal obligation or through a moral obligation, it might be called upon to make. In that respect it differs from the purpose of the present policy, which was not to enable the company to make payments to Mr. Crawford, but to give the company something to make up for the loss which the company would sustain if it were to be deprived of Mr. Crawford's services. Under the policy a sum of £15,000 was payable in the case of death or disabling injuries of a specified character, the occurrence of which would obviously have interfered with his services, or deprived the company of them altogether; then there is a provision of £50 a week in respect of temporary partial disablement from engaging in or giving attention to profession or occupation. Bearing in mind the object of this policy, if Mr. Crawford had, for instance, suffered a temporary disablement over a period of six months, and the company had thereby been deprived of his services during that period, the company would, under this policy, have been receiving £50 a week, and that £50 a week would have been received by it, not for the purpose of handing it over to Mr. Crawford but for the purpose of putting it into its own coffers in order to make up in whole or in part for the loss which it would suffer by being deprived of his services during that period. The provisions of the policy, therefore, fall into line with the general purpose which the company had in taking it out.

In point of fact, what happened was that Mr. Crawford unfortunately was killed in an accident. The company, therefore, was deprived for ever of his services in the future, and its assets were increased by the sum of £15,000 received under the policy. That sum was distributed among the shareholders. What we have to consider is whether that sum of money received in the circumstances which I have stated and being of the nature which I have stated, is to be treated for Income Tax purposes as capital or income.

It is useful to consider whether there is any broad class into which payments of this character can be said to fall. I think it just to observe as a purely general proposition that in the case of a trading company both goods and services fall into the same class. The expenditure incurred in procuring the goods or producing the goods in which a person trades and the benefits derived from disposing of those goods are obviously of a revenue character. Similarly the expenditure incurred by a person in securing the services of his employees and the benefits derived from those services, reflected as they are in the output and profits of the employer, are again, generally speaking, of a revenue character. The matter can be carried a little further in the case of goods. Not merely are the profits derived from the sale of goods in which a person trades of a revenue character, but insurance moneys received in respect of the loss of trade goods are proper receipts to appear in a revenue account. If a company insures its stock of goods against fire and that stock is destroyed by fire, however great and valuable it may be, the receipts must be treated in exactly the same manner as receipts from a sale of the goods would have been treated. The trader, it is true, as has been said, does not trade in fires but in goods, but if he disposes of the whole of his stock by sale or if the whole of his stock is destroyed by fire and the insurance money is received, there can be no ground for differentiating for tax purposes between the purchase money and the insurance money.

It seems to me that the benefits derived from a service contract fall into the same broad class. Suppose a company has a particularly valuable servant

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engaged under a contract of service. So long as that contract remains in force the salary which the company pays is expenditure on revenue account. The benefits which the company receives are reflected in its output and the profits that it makes. They are equally matters for revenue account. If during the course of that employment the servant is temporarily incapacitated the company's revenue account is affected by reason of the fact that during the incapacity it produces less goods or earns less profits. It may say to itself: "The services of this employee are so important for our business that "it is worth our while by way of insurance to protect ourselves against the "loss which we shall suffer in our trade if he is temporarily incapacitated." That loss is, of course, of two kinds: (1) the payment of salary during the incapacity, and (2) the actual loss of the profits which the company would otherwise have made. If the company takes out a policy for a sum which the directors estimate will fairly represent the loss or part of the loss—it matters not—which they will suffer if they are deprived of those services, can it be said that the £50 a week, or whatever the figure may be, that the company receives under such a policy is anything but a revenue receipt? It seems to me that the insurance moneys received to cover the company against the revenue loss which it suffers by being deprived of those services are receipts on revenue account and nothing else. But supposing the company carries the matter a step further and says: "We shall suffer loss not "merely by the temporary incapacity of our servant, but if he dies during "the period of service we shall suffer a very much greater loss", and, with that in mind, it decides to extend the insurance to cover the death of this valuable servant and insures his life accordingly for a lump sum. Whether or not the directors' estimate of the loss which they will suffer by the death of that servant is accurately reflected in the sum which they fix for his insurance is neither here nor there. The important matter is the object of the insurance, which may or may not be entirely achieved according to the accuracy of the estimate made. What would be the position if after taking out that policy the employee happened to die, with the result that the company was deprived of those benefits on revenue account which it would have received if it had continued to enjoy his services? There is no magic here in the distinction between a lump sum and a periodical sum. The question is: What is the nature of the sum? And although the fact that there is a lump sum paid once and for all rather tends to colour the question and to make one inclined to regard it as of a capital nature, that, in my opinion, is apt to be misleading. To go back to the example I took a moment ago of temporary incapacity, I myself cannot see what difference there can be between a case where the insurance takes the form of a weekly payment and a case where it takes the form of a lump sum payment to cover some defined period. Similarly in the case of death, the fact that a lump sum is paid cannot, in my view, differentiate the case from one where a periodical payment is made year by year under a policy during the unexpired part of the contract of service. Suppose that the policy, instead of providing that the company should receive a lump sum on death, provided that during the remainder of the period of service between the death and the end of the term the company should receive a yearly sum, the object to compensate it for the estimated loss it would sustain. I cannot see that there can be any difference between the two cases. My view that insurance moneys received in circumstances such as those which I have described are really receipts on revenue account can be tested in the case, for instance, of a particularly valuable commission agent. A company might be in a position to estimate with very considerable accuracy the amount of business which it was likely to get from a particular commission agent, and it might be in a position to fix very closely the

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appropriate sum for insurance against his incapacity or death. It seems to me that whether the amount of the insurance is fixed on an estimate which in the circumstances can be made with substantial accuracy, or whether it is fixed on the basis of a broad estimate by the employer as to the sum for which it will be worth his while to insure the employee, makes no difference. Therefore it seems to me that in this case the receipt must be treated as a receipt on revenue account.

The matter can be looked at from rather a different point of view. I do not wish to lay down any general proposition which would lead to the result that the test in the case of payments is necessarily the same as the test in the case of receipts. In the case of payments the question whether they are to be treated as deductible expenses is complicated by the special provisions of the Income Tax Acts which lay down certain categories of expenditure which are not deductible. But looking at the matter from the broader point of view, on the question whether a particular item of expenditure or a particular item of receipt falls into the category of revenue expenditure or receipt, or capital expenditure or receipt, I think assistance is to be obtained from examination of cases which have dealt with the question of expenditure. I do not propose to go into the various cases which have been cited to us, but the case of *B. W. Noble, Ltd.* v. *Mitchell,* 11 T.C. 372, is perhaps the best example. That was a case, putting it shortly, in which the company found it advisable to pay money in order to get rid of a servant whose services they no longer required and who in point of fact was embarrassing to the company. It was held that the sums paid in order to get rid of that servant were admissible deductions. If when an employer finds it desirable to expend money in getting rid of an onerous contract of service, the expense incurred is a revenue expense, it does seem to me to follow that the money received in respect of the loss of a beneficial contract of service falls into the same category; and, apart from the fact that no actual contract existed, that appears to me to be the present case.

There is one more case to which I may refer, the case in the Privy Council to which our attention was called. That is the case of *The King* v. *B.C. Fir and Cedar Lumber Co., Ltd.,* [1932] A.C. 441. It is perfectly true that the Income Tax Act which was being dealt with there was different in language from our own Income Tax Acts, but it does afford an illustration of what happens in the matter of insurances of a particular character. I think the result of that case is of general application in this sense. The particular matter of insurance that was being dealt with there was an insurance against loss of profits. A manufacturer can, of course, insure his factory against fire. The receipts from that insurance will obviously be capital receipts. But supposing he goes further, as the manufacturer did in that case, and insures himself against the loss of profits which he will suffer while his factory is out of action; it seems to me it is beyond question that sums received in respect of that insurance against loss of profits must be of a revenue nature. Similarly the moneys received under a policy of insurance against the loss of profits through the loss of a valuable servant must in essence be receipts of a revenue nature. As I have already said, I can draw no distinction between the case where the receipts under such an insurance take the form of periodical payments and the case where they take the form of a lump sum paid down.

The cases which were relied upon by Mr. Daynes on behalf of the Appellants do not, in my opinion, support his proposition. The two main ones were *Chibbett* v. *Joseph Robinson and Sons,* 9 T.C. 48, and *Du Cros* v. *Ryall,* 19 T.C. 444. *Chibbett* v. *Joseph Robinson and Sons* was a case in which a firm of ship managers, whose sole business consisted in managing

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the ships of a particular company, received in the liquidation of that company a sum of £50,000. The question was whether that sum ought to be treated as part of the profits of their business. When the employing company went into liquidation the business of the firm of ship managers came to an end, and the receipt was held to be not a receipt from business activities but in the nature of a voluntary payment made as compensation for the loss of the profits of their employment under the company which had terminated. It seems to me that that stands in quite a different category from the present case.

The other case, of *Du Cros* v. *Ryall*(1), was a case in which the general manager of a company working on a fixed salary and a commission on profits had a contract for a fixed term which was repudiated by the employing company. He brought an action which was compromised, and the question was whether the large sum paid as agreed damages under that compromise was assessable under Schedule E. The contract of service was at an end. The source of income had disappeared, and the sum paid by way of damages could not be regarded as a sum derived from the employment. It was something which arose outside the employment. It was something to which Mr. Du Cros became entitled by reason of the disappearance of the employment. It was, therefore, of quite a different character from insurance moneys received by a going concern in order to recoup it for the loss suffered through the death or disablement of a valuable servant, or, as in this case, of a person associated with the company without a contract of service whose services, from a business point of view, the company might reasonably anticipate would continue.

In my opinion, as I have said, the learned Judge came to the right conclusion in this case, and the appeal must be dismissed with costs.

Scott, L.J.—I agree.

MacKinnon, L.J.—I agree.

Mr. Scrimgeour.—My Lords, I am instructed to ask your Lordships for leave to appeal in this case in the event of the Executors being so advised after consideration of your Lordships' judgment.

Lord Greene, M.R.—Very well, Mr. Scrimgeour—unless you have anything to say, Mr. Attorney?

The Attorney-General.—No, nothing at all, my Lord.

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., and Lords Atkin, Thankerton, Russell of Killowen and Porter) on 28th and 29th February, 1944, and on the latter date judgment was given unanimously in favour of the Crown, with costs, confirming the decision of the Court below.

Mr. Raymond Needham, K.C., and Mr. J. S. Scrimgeour appeared as Counsel for the Executors, and the Attorney-General (Sir Donald Somervell, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Viscount Simon, L.C.—My Lords, in my opinion, this appeal should be dismissed, and I am content to rest my view upon the convincing judgment of the Master of the Rolls.

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(1) 19 T.C. 444.

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The question whether a particular item is to be regarded for Income Tax and Sur-tax purposes as capital or income may involve questions both of law and of fact. But, in the present case, the Commissioners' determination does not appear to me to disclose any conclusion of fact which would justify the view in law that the policy moneys were received by the company otherwise than as a receipt of income. Consequently the appeal fails.

I move that the appeal be dismissed with costs.

Lord Atkin.—My Lords, I agree.

Lord Thankerton.—My Lords, I also agree.

Lord Russell of Killowen.—I agree, my Lords.

Lord Porter.—My Lords, I concur.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

That the Order appealed from be affirmed and that the appeal be dismissed with costs.

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue; Evill & Coleman.]