
COURT OF APPEAL—26TH AND 29TH FEBRUARY, AND 1ST AND 24TH MARCH, 1960

HOUSE OF LORDS—16TH, 17TH AND 18TH JANUARY, AND 13TH FEBRUARY, 1961

Trustees of the Tollemache Settled Estates

v.

Coughtrie (H.M. Inspector of Taxes) (1)

Income Tax, Schedule D—Excess rents—Sand royalties—Income Tax Act, 1952 (15 & 16 Geo. VI & 1 Eliz. II, c. 10), Section 175.

In 1946 the Appellants demised a sandpit to tenants for a term of 21 years at a surface rent of £10 per annum and a royalty of 6d. a ton for all sand worked. Under a provision of the lease the tenants were permitted in September, 1953, to occupy a further area at a surface rent of £5 an acre. There was no separate assessment to Income Tax under Schedule A in respect of the sandpit before the year 1953–54; for that year the original area was assessed at a net annual value of £3 5s., and a further assessment was subsequently made to take account of the increased area. The royalties received for 1953–54 amounted to £646.

On appeal to the General Commissioners against an assessment to Income Tax under Schedule D for the year 1953–54 in respect of the excess of the surface rents and royalties over the Schedule A assessment, the Appellants contended that the only rents to which they were entitled within the meaning of Section 175, Income Tax Act, 1952, were the surface rents; alternatively, that if Section 175 applied to the royalties, the notional Schedule A assessment required by that Section should be based on a rack rent not exceeding £292, the figure which they claimed that a tenant taking a 21-year lease in 1946 might have been prepared to pay on the estimated tonnage of sand. For the Crown it was contended that the royalties were rent and an assessment fell to be made under Section 175 by reference to the rent, including royalties, paid in the year and the other terms of the lease. The Commissioners decided that the royalties were covered by Section 175 and the assessment should be on the excess of the dead rent together with the royalties received during the current year over the Schedule A assessment.

Held, in the Chancery Division, that the royalties should be treated as part of the rent.

Held, in the House of Lords, that the assessment should be made by reference to the actual rent receivable for the year and the other terms of the lease relevant to adjustments warranted by Part III of the Income Tax Act, e.g., that the landlord shall pay rates (Section 86) or the tenant do repairs (Section 88).

(1) Reported (Ch.D.) [1959] 1 W.L.R. 900; 103 S.J. 544; [1959] 2 All E.R. 582; 227 L.T.Jo. 348; (C.A.) [1960] Ch. 475; [1960] 2 W.L.R. 825; 104 S.J. 386; [1960] 2 All E.R. 122; 229 L.T.Jo. 266; (H.L.) [1961] A.C. 880; [1961] 2 W.L.R. 318; 105 S.J. 176; [1961] 1 All E.R. 593; 231 L.T.Jo. 121.

CASE

Stated under Section 64 of the Income Tax Act, 1952, by the Commissioners for the General Purposes of the Income Tax for the Drayton Division of Shropshire for the opinion of the High Court of Justice.

1. At a meeting of the Commissioners for the General Purposes of the Income Tax for the Drayton Division of Shropshire held at 46, Cheshire Street, Market Drayton, on Tuesday, 8th October, 1957, the Trustees of the Tollemache Settled Estates (hereinafter called "the Appellants") appealed against an assessment to Income Tax made upon them under Schedule D of the Income Tax Act, 1952, for the year 1953-54. The assessment appealed against was an assessment in the sum of £5 in respect of excess rents and in the sum of £1,000 in respect of royalties.

2. We found the following facts admitted or proved on the evidence adduced at the hearing of the appeal :

(1) By a lease dated 17th December, 1946, and made between Eustace Bowles and the Count de Salis (who were at that date the Trustees of the Tollemache Settled Estates), of the one part, and Joseph William Weston, John Herbert Weston and Walter Weston, trading together in partnership as the Tarvin Supply Co., of Tarvin in the county of Chester (therein and hereinafter called "the tenants"), of the other part, the Appellants demised to the tenants for a term of 21 years from 25th March, 1946, a sandpit at Beeston in the county of Chester, being a sandpit on the Peckforton estate forming part of the Tollemache Settled Estates. A copy of the said lease is attached and forms part of this Case (Exhibit A⁽¹⁾).

(2) So far as material, clause 2 of the said lease provided as follows :

"2. In consideration of the rents and royalties hereinafter reserved and of the covenants, conditions and agreements hereinafter contained and by the Tenants to be paid observed and performed the Lessors hereby demise unto the Tenants the following liberties:— (a) Liberty for the Tenants to enter upon and occupy the said land (b) Liberty for the tenants and their servants and workmen . . . to dig raise and get by open surface workings in and from the said land the demised sand."

(3) Clause 6 of the said lease provided that the tenants should pay a surface rent of £10 per annum and a royalty of 6*d.* per ton for all sand worked and gotten from the demised land. Clause 6 further provided that the said rent and royalties should be due and payable quarterly.

(4) The area originally demised to the tenants was an area of approximately two acres and nine perches. Clause 10 of the said lease provided that if and when the tenants should have worked and removed from the demised land all the demised sand or so much thereof as could reasonably be worked they should be entitled from time to time during the term to occupy and work and to remove sand from certain additional land adjoining the land originally demised. Clause 10 further provided that as from the date of such occupation the tenants should pay to the Appellants, in addition to the surface rent and royalty referred to in clause 6, a yearly surface rent at the rate of £5 per acre in respect of all additional land from time to time occupied. In accordance with the provisions of clause 10, the tenants occupied an additional five acres from 29th September, 1953.

(5) In previous years the Beeston sandpit was not separately assessed to tax under Schedule A, but for the year 1953-54 an assessment under Schedule A in respect of the sandpit was made upon the tenants as follows :

(1) Not included in the present print.

	£	s.
Gross annual value	3	15
Repairs allowance		10
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Net annual value	£3	5

This assessment was made by reference to the original area of the sandpit, the additional five acres taken over by the tenants in September, 1953, being covered by the separate assessment on Mill Farm, of which the land originally formed part.

(6) Particulars of the sand extracted and the royalties paid from the commencement of the term to 31st March, 1956, are shown in the following table :

<i>Quarter year to</i>	<i>Weight of sand Tons</i>	<i>Royalties</i>			<i>£ s. d.</i>		
		<i>£</i>	<i>s.</i>	<i>d.</i>	<i>£</i>	<i>s.</i>	<i>d.</i>
30th June, 1946	803	20	1	6			
30th September, 1946	741	18	10	6			
31st December, 1946	828	20	14	0			
31st March, 1947	1,493	37	6	6			
	<hr/>						
		3,865			96	12	6
30th June, 1947	1,548	38	14	0			
30th September, 1947	1,353	33	16	6			
31st December, 1947	1,485	34	12	6			
31st March, 1948	1,541	38	10	6			
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		5,927			145	13	6
30th June, 1948	1,992	49	16	0			
30th September, 1948	1,552	38	16	0			
31st December, 1948	1,754	43	17	0			
31st March, 1949	1,586	39	13	0			
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		6,884			172	2	0
30th June, 1949	2,371½	59	5	9			
30th September, 1949	2,469	61	14	6			
31st December, 1949	4,101	102	10	6			
31st March, 1950	4,909	122	14	6			
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		13,850½			346	5	3
30th June, 1950	5,804	145	2	0			
30th September, 1950	5,332	133	6	0			
31st December, 1950	5,118	127	19	0			
31st March, 1951	5,130	128	5	0			
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		21,384			534	12	0
30th June, 1951	5,881	147	0	6			
30th September, 1951	5,280	132	0	0			
31st December, 1951	6,700	167	10	0			
31st March, 1952	7,776	194	8	0			
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		25,637			640	18	6

<i>Quarter year to</i>	<i>Weight of sand Tons</i>	<i>Royalties £ s. d.</i>	<i>£ s. d.</i>
30th June, 1952	8,485	212 2 6	
30th September, 1952	8,510	212 13 0	
31st December, 1952	8,592	214 16 0	
31st March, 1953	8,086	202 3 0	
	33,673		841 14 6
<i>Half year to</i>			
30th September, 1953*	13,040	326 0 0	
31st March, 1954	12,802	320 1 0	
	25,842		646 1 0
30th September, 1954	17,653	441 6 6	
31st March, 1955	16,883	422 1 6	
	34,536		863 8 0
<i>Quarter year to</i>			
30th June, 1955	10,756	268 18 0	
<i>Half year to</i>			
31st December, 1955	16,497	412 8 6	
<i>Quarter year to</i>			
31st March, 1956	6,780	169 10 0	
	34,033		850 16 6

* Extra five acres taken from 29th September, 1953.

3. Evidence was given on behalf of the Appellants by Mr. Michael Angus Oliver Hedley, a chartered surveyor and chartered land agent, to the effect that in his opinion a reasonable fixed rent for the original area of the sandpit, together with the additional five acres taken over in September, 1953, for a 21 years' lease from 25th March, 1946, would have been £292 per annum. Mr. Hedley based his calculation on what a tenant taking a 21-year lease in 1946 might have been prepared to pay by way of rent on an estimated tonnage of sand available in the area of 446,000 tons.

Evidence was given on behalf of the Crown by Mr. George Alexander, the Superintending Valuer (Minerals) in the Inland Revenue Valuation Office. His estimate of what a tenant might have been expected to pay by way of fixed rent for a 21-year lease in 1948 was £500 per annum. Mr. Alexander's calculation was based on an estimated tonnage of sand available in the area of 462,825 tons.

Both witnesses were of the opinion that a sandpit would rarely be let at a fixed rack rent for a term of 21 years. The only terms of letting satisfactory to both landlord and tenant were those adopted in the present case, whereby the tenant paid a small fixed rent and a royalty per ton of sand extracted.

We do not find it necessary to decide the question what rent a tenant might have been prepared to pay for the area covered by the assessment under appeal if offered a lease for 21 years in 1946.

4. As to the alternative approach put forward on behalf of the Crown (see paragraph 6(3) below), the witnesses said that, if asked to estimate at the beginning of a year a fair annual value for occupation of the sandpit over the coming year, they would have to consider all the circumstances, including the results of the previous year's working and the likely commercial demand for sand in the coming year. In the absence of any significant change of circum-

stances, their valuation would not differ greatly from that shown by the previous year's working.

5. On behalf of the Appellants it was contended:

- (1) That, in so far as the assessment under appeal purported to be an assessment in respect of royalties, there was no provision of the Income Tax Act under which such an assessment could be made.
- (2) That, in so far as the assessment under appeal purported to be an assessment in respect of excess rent under Section 175, Income Tax Act, 1952, the only rent to which the Appellants, as immediate lessors, were entitled within the meaning of that Section was the surface rent payable under clause 6 (i) of the said lease and any additional surface rent payable under clause 10.
- (3) That Section 175 of the Income Tax Act, 1952, did not justify an assessment being made after the end of the year of assessment by reference to the royalties actually paid by the tenants in the year of assessment. Section 175 could only operate where the immediate lessor was entitled to rent payable under a lease the amount of which could be quantified at the beginning of the year of assessment.
- (4) That, if Section 175 of the Income Tax Act, 1952, was applicable, the Section required a notional Schedule A assessment to be made in accordance with the provisions of Section 82 (2) of the Income Tax Act, 1952. Any such notional Schedule A assessment should be made on the footing that the rack rent at which the land in question was worth to be let by the year did not exceed £292.
- (5) That the appeal should be allowed and the assessments reduced.

6. On behalf of the Crown it was contended:

- (1) That the royalties payable under the lease dated 17th December, 1946, were "rent" for the purposes of Section 175 of the Income Tax Act, 1952.
- (2) That an assessment fell to be made under Section 175 for the year 1953-54 by reference to the rent, including royalties, paid in that year and the other terms of the lease.
- (3) Alternatively, that if, contrary to the Crown's contentions, the value of the lessor's rights had to be ascertained before the beginning of the year, it should be estimated afresh at the beginning of each year in the light of the facts then known.
- (4) In the further alternative, that, if an annual value over the whole term of the lease had to be ascertained, that value in this case should be £500.

7. We, the Commissioners who heard the appeal, upon consideration of the evidence adduced and the arguments addressed to us on behalf of the parties, gave our decision as follows:

(1) We have decided that in this case royalties are covered by Section 175 of the Income Tax Act, 1952, and should be taxed as excess rents under Case VI of Schedule D.

(2) The assessment for tax will be the excess received above the Schedule A assessment, and this figure is the dead rent received, namely £35, plus the actual royalties received during the current tax year, £646, less the Schedule A assessment.

8. We were subsequently informed that for the year 1953-54 a further assessment had been raised on the sandpit under Schedule A, which took account of the increased area of occupation from 29th September, 1953, and

that the parties had agreed a figure of £577 to give effect to our decision set out in paragraph 7. We accordingly reduced the assessment to £577.

9. Immediately after the determination of the appeal dissatisfaction therewith as being erroneous in point of law was expressed to us on behalf of the Appellants, and in due course we were required to state a Case for the opinion of the High Court, pursuant to Section 64 of the Income Tax Act, 1952, which Case we have stated and do sign accordingly.

10. The point of law for the opinion of the High Court is whether, on the facts found, our decision was correct in law.

A. Heywood-Lonsdale Warwick W. Rogers E. G. S. Harding	}	Commissioners for the General Purposes of the Income Tax for the Drayton Division of Shropshire.
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The case came before Upjohn, J., in the Chancery Division on 8th and 11th May, 1959, when judgment was given against the Crown, with costs.

Mr. H. H. Monroe appeared as Counsel for the Trustees, and Mr. R. O. Wilberforce, Q.C., and Mr. Alan Orr for the Crown.

Upjohn, J.—This is an appeal from the General Commissioners for the Drayton Division of Shropshire against an assessment of tax under Schedule D for the year 1953–54 in the sum of £5 in respect of excess rents and £1,000 in respect of royalties. The matter arises in this way. The Appellants, the Trustees of the Tollemache Settled Estates, have estates in the county of Chester, and included in those estates is the Peckforton estate, which has on it a sandpit. By a lease dated 17th December, 1946, the Trustees let to certain persons, trading as the Tarvin Supply Company, the sandpit for a term of 21 years from 25th March, 1946. The demised area was two acres and nine perches. The lease is annexed to the Case, and therefore I propose to summarise its terms very briefly. There was liberty to the tenants to enter upon and occupy the land and to dig, raise and get by open surface workings the sand in the demised land. There was to be a surface rent of £10 per annum and a royalty of 6d. per ton for all sand worked. There was provision that the tenants might enter and remove sand from certain additional land when they had worked out all that could reasonably be worked from the land originally demised, and pursuant to that liberty the tenants occupied an additional five acres of this sand-bearing land from 29th September, 1953. In former years the sandpit was not separately assessed to tax under Schedule A, but for the year with which I am concerned an assessment under that Schedule was made upon the tenants for the small sum of £3 5s., and, although it does not directly emerge from the Case, it appears that there was an additional assessment for the five acres of land which they took in addition; and I think the whole of the Schedule A assessment was something in the neighbourhood of £11 or thereabouts. Sand, after the war, was a valuable commodity, and it is quite plain from the figures set out in the Case that the tenants have made much use of their powers under the lease. In the first year—that is 1946–47—the royalties payable were just under £100. That has gone up fairly steadily until in the year 1955–56 it amounted to some £850, an average of about £390 per annum.

The assessment is made pursuant to Section 175 of the Income Tax Act, 1952, and I will read that Section straight away:

“(1) If, as respects any year of assessment, the immediate lessor of a unit of

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assessment is entitled in respect of the unit to any rent payable under a lease or leases to which this section applies, he shall be chargeable to tax under Case VI of Schedule D in respect of the excess, if any, of the amount which would have been the amount of the assessment of the unit for the purposes of Schedule A, as reduced for the purpose of collection, if the annual value of the unit had been determined (in accordance, in whatever part of the United Kingdom the unit is situated, with the provisions of Part III of this Act) by reference to that rent and the other terms of the lease or leases, over whichever is the greater of—(a) the actual amount of the assessment of the unit for the purposes of Schedule A, as reduced for the purpose of collection . . .”

Paragraph (b) I need not read, because it is admitted that this is a paragraph (a) case. I do not think I need read Sub-sections (2) and (3). Sub-section (4) defines the leases to which the Section applies, and it is admitted that this lease is a lease to which the Section is applicable. It became applicable to it when the separate assessment was made in respect of the year 1953–54.

The question is whether an assessment can be made under this Section, in effect, on the rent and royalties which the Appellants received under the demise, but before dealing with that question I think it will be convenient to say one or two words about the relevant legislative history. Until the decision of the House of Lords in 1948 in *Scott v. Russell*, 30 T.C. 394, it was generally thought that the profits from licences or leases of sand and gravel and other minerals of that sort were assessable to tax under the provisions of Schedule D, and for the reason (if I may for convenience refer to the Income Tax Act, 1952, which replaced the relevant provisions of earlier Acts) that, by Section 82, tax is to be charged under Schedule A

“in respect of the property in all lands, tenements, hereditaments and heritages in the United Kingdom”,

and so on, with the proviso that

“tax in respect of certain lands, tenements, hereditaments or heritages in the United Kingdom, that is to say, in the case of the following concerns”

—and then there is set out quite a long list—shall be charged to tax not under Schedule A but under Case I of Schedule D. It was thought, as I have said, that with sand leases the profits were taxable by virtue of the proviso under Schedule D, and until 1948 the profits were so taxed. Then the House of Lords in the case I have mentioned held that that was the wrong view to take and accordingly the assessment under Schedule D ceased, and nothing was done about Schedule A until 1953–54 in the case before me. Well, that was one difficulty.

Now a few words about the reason for Section 175. It admittedly hits this case; it hits these Appellants. Admittedly it does so by chance or mistake. The reason for Section 175 (formerly Section 15 of the Finance Act, 1940) is set out in the speech of Lord Asquith of Bishopstone in *Littman v. Barron*, 33 T.C. 373, at page 411, where he said this:

“The activity on which the Respondent was engaged was that of acquiring property—freehold or leasehold—with the design of letting, or re-letting it at a commercial profit to himself. Under the *Salisbury House* decision⁽¹⁾ it had been established that profit resulting from a transaction of this kind and consisting of the difference between net outlay and net return, could not be taxed as such under Schedule D, and that the only Income Tax liability which could attach in such a case was one on the annual value of the property under Schedule A. This was held to exhaust the tax gatherer's rights. The system worked fairly, so long as Schedule A value was frequently revised and so kept in step with commercial value. But when, during the war, quinquennial re-valuations under this Schedule were suspended, an increasing disparity declared itself between the old Schedule

(1) *Salisbury House Estate, Ltd. v. Fry*, 15 T.C. 266.

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A values and the rents which the premises in fact commanded in the market, and therewith an increasing tax-free commercial profit lodged in the hands of the *entrepreneur*."

Pausing there, no one thought Section 175 had any application to the case of a lease such as I have before me, for the simple reason that it was thought that such a lease would be subject to tax under Schedule D, as I have already explained. Lord Asquith continued (1):

"Section 15 of the 1940 Act was clearly designed to 'catch' this profit. It might have provided—I leave aside for the sake of simplicity, freeholds—that in the case of property acquired on lease and re-let, the subject matter of tax should be simply and in all cases the difference between rent payable and rent receivable, less expenses. It did not in fact so provide. The new, and the only new, subject matter of tax was what may be called for short 'excess rents': a figure arrived at by the application of an arbitrary formula laid down in the Section. Excess rent (again leaving freeholds for simplicity out of account) would very frequently be the excess of the rent at which the premises were re-let, over the Schedule A value, a figure which might be almost unrelated to actual commercial profits. (The wording of the Section is complex but I do not think this statement is a dangerous over-simplification of its gist, at least on the facts of this case.) The Section provided that 'excess rent', computed according to this formula, should be 'chargeable under Case VI of Schedule D'. Case VI deals, and deals solely, with 'profits or gains' in the Income Tax sense of those terms; and it is impossible to suppose that the Section would have operated differently if it had provided in terms that excess rents should be 'deemed to be "profits or gains" within Case VI' and chargeable as such."

Now the respective contentions may, I think, be summarised in this way. Counsel for the Appellants says, first, that rent in the Section includes only the fixed rent. From his point of view whether that is so or not is not of prime importance, because he admits that when you look at the lease, as Section 175 directs you to do, it directs you to look at the rent and other terms of the lease, and one of the other terms which you have in mind is the fact of large royalty payments. However, he submits on the first point, first, that the assessment has to be an assessment only upon the flat rent, and, alternatively, on the flat rent and royalties. That is his alternative, and he submits that in order to achieve that result you must apply Schedule A principles. I must turn, therefore, to Schedule A, which is now Section 82 of the Income Tax Act, 1952. I have read Paragraph 1 so far as it was relevant, and I turn, then, to Paragraph 2:

"The annual value for the purposes of this Schedule shall, in the case of all lands, tenements, hereditaments or heritages, of whatever nature and for whatever purpose occupied or enjoyed, and of whatever value, be understood to be—(a) if they are let at a rack rent and the amount of that rent has been fixed by agreement commencing within the period of seven years preceding the fifth day of April next before the time of making the assessment, the amount of the rent by the year at which they are let; or (b) if they are not let at a rack rent so fixed, then the rack rent at which they are worth to be let by the year".

He submits that Section 175 works in this way: that admittedly it creates a charge under Case VI of Schedule D, but for the purpose of computing the amount of that charge you must apply Schedule A principles; and he submits that, in a case such as this, if you include royalty as rent it is not a letting at a rack rent but it is a Paragraph 2 (b) case—

"the rack rent at which they are worth to be let by the year"

—and therefore it is the duty of the Commissioners to look at the terms of the lease and nothing else, and hear evidence upon the matter, and fix a rent at which the properties are worth to be let by the year. Such evidence was in

(1) 33 T.C., at pp. 411-2.

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fact given before the Commissioners. On behalf of the Appellants it was stated that such a rent was £292 a year, and on behalf of the Crown it was stated that the value was £500 per annum. Whatever the quantitative result, he submits that that is the proper computation to be made. You then deduct the amount of the Schedule A, and upon the balance an assessment is made under the provisions of Case VI of Schedule D.

The Crown's case is this. You make an assessment year by year on the basis of the actual receipts, and you do that because the charge is admittedly a charge under Case VI of Schedule D. The Section makes that abundantly plain, and it was indeed pointed out in all the speeches in the House of Lords in *Littman v. Barron* (1). Therefore the Crown submits that you take each year the actual receipts by way of royalty. There is a small additional point, the question as to whether you should take it at the beginning of the year and make an estimate of royalties likely to be received for the year or whether you should wait until the end of the year and take the actual figures, but that is only a minor point; but you take the actual receipts, or prospective receipts, and you treat that as the rent. You then, it is said, insert that figure in the Schedule A machinery. You deduct one-eighth under the general provisions applicable to Schedule A cases; there may be maintenance payments to be allowed; and you get a figure from which you deduct the amount of the actual Schedule A. But the whole basis of the Crown's claim is that you take the figures of the royalties year by year.

Now, the whole question is which of those is right. As I have already pointed out, it is very difficult to make the Section fit this case, because it was never directed to fit such a case. It is very reasonable to talk of Schedule A when you are dealing with the sort of case they had in the House of Lords in *Littman v. Barron*, but it is difficult to make it fit the case before me. However, it is not an unfamiliar task in these Courts to make Sections of Revenue Acts fit circumstances that they were never designed to meet.

I turn back, therefore, to Section 175. It is perfectly true that it starts off:

"If, as respects any year of assessment, the immediate lessor of a unit of assessment is entitled in respect of the unit to any rent payable under a lease . . ."

That, it is said, indicates, especially as the assessment is to be under Schedule D, that there is to be an annual assessment, and it is said that you then take the rent and royalties for that year. It was submitted that the word "entitled" really meant no more than "receive" or "receivable". I do not feel able to accept that view, which is contrary to the view expressed by Vaisey, J., in *Strick v. Longsdon*, 34 T.C. 528. If the word "entitled" meant "receive", so that you took actual profits, it is clear that that case must have been decided in another way; but, speaking for myself, it seems to me that these introductory words do no more than provide the background necessary to establish a liability to taxation. You have got to have an immediate lessor who is entitled to gain under some lease. There is nothing in the Section that I can see which entitles you to take the amount of that rent and use it as the basis, as it has been expressed, for feeding it into Schedule A machinery. Indeed, the words of Lord Asquith that I have already quoted (2) would seem to make it difficult to do so and to go some way, at all events, to negating that view. You find, therefore, that the lessors are entitled to rent. If so, they are chargeable to tax under Case VI of Schedule D. That imposes quite plainly a liability upon them, but the computation to reach the amount of the liability is this, and I will leave out words in the Section which are immaterial. It is

(1) 33 T.C. 373. (2) 33 T.C., at pp. 411-2.

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"the excess, if any, of the amount which would have been the amount of the assessment of the unit for the purposes of Schedule A . . . if the annual value of the unit had been determined . . . by reference to that rent and the other terms of the lease or leases, over whichever is the greater of"

Schedule A—I leave out the words "as reduced for the purpose of collection", which only refer to repairs allowances and so forth, and I leave out the words in brackets, although in fact I know that Part III of the Act is the Part which deals with the machinery of Schedules A and B and not with Schedule D. However, what the Act directs the Commissioners to do is to find out what would have been the amount of the assessment of the unit for the purpose of Schedule A by reference to the rent and the other terms of the lease or leases, and it seems to me that that is a notional figure. That is quite plain from the speeches in *Littman v. Barron*⁽¹⁾, but it seems to me that it drives the person having to make the computation straight into Schedule A, and I cannot see how you can be justified in taking the actual rent and then making Schedule A computations. It seems to me that the whole figure for computation purposes has to be assessed by Schedule A principles, and you therefore turn to Schedule A and see whether it is a Paragraph 2 (a) or a Paragraph 2 (b) case.

In this particular case I do not know that there will be very much difference, but it seems to me that the essence of the matter is that you must make a computation either by treating this variable rent as a rack rent and averaging it out, as was done in *Commissioners of Inland Revenue v. Dickson's Executors*, 14 T.C. 69, or by treating it as a Paragraph 2 (b) case, looking at all the terms of the lease and finding out over the term of 21 years what would be the proper rack rent. I am not going into the question of whether that process can be repeated every year and different results reached. I say nothing about that, but the essence of the matter is to make a computation of a notional figure of rent, and that is the process which the Commissioners should have gone through. However, they did not do that; they accepted the view of the Crown that you took the royalties in each year. In my judgment that was wrong, and the case must be remitted to them to go through the process I have mentioned.

Now of course they will desire to have a direction, although I do not think myself that it will make very much difference, on the question of the meaning of the word "rent", and it seems to me that that matter was really determined over one hundred years ago in *Reg. v. Westbrook* (1847), 10 Q.B. 178, when Lord Denman, C.J., dealt with the question of royalties very fully, and he came to the conclusion, at any rate in a rating Act, that royalties should be treated as part of the rent, and that seems to me to be applicable in this case. In coming to that conclusion, Lord Denman followed his own earlier decision in *Daniel v. Gracie* (1844), 6 Q.B. 145, and it seems to me that that case covers this and that, for the purpose of rent, royalties must be included.

Accordingly, for those reasons the matter must be remitted to the General Commissioners to assess the proper rent at which the demised property should be held. It seems to me, again by way of giving directions which I hope will be of assistance, that they must look at the matter as at the moment of assessment—that is, in the year 1953–54—and they can look at the royalties which had been received. They can then look into the future and, aided, no doubt, by expert evidence, they will come to a conclusion as to what the royalties are likely to be in the future, and then make some assessment as to the rent. The matter being remitted, the Crown, I think, must pay the costs of this appeal.

(1) 33 T.C. 373.

The Crown having appealed against the above decision, the case came before the Court of Appeal (Lord Evershed, M.R., and Pearce and Harman, L.J.J.) on 26th and 29th February, and 1st March, 1960, when judgment was reserved. On 24th March, 1960, judgment was given unanimously in favour of the Crown, with costs.

Mr. R. O. Wilberforce, Q.C., and Mr. Alan Orr appeared as Counsel for the Crown, and Mr. H. H. Monroe for the Trustees.

Lord Evershed, M.R.—I have asked Pearce, L.J., to deliver the first judgment.

Pearce, L.J.—This case concerns the assessment of certain royalties received by the taxpayers in respect of sandpits let by them. These royalties are admittedly covered by Section 175 of the Income Tax Act, 1952, and fall to be taxed as excess rent under Case VI of Schedule D. The Crown contend that the assessment should be made year by year on the basis of the actual receipts, subject to certain deductions. The General Commissioners adopted that view. On an appeal by the taxpayers, who contended that there must be an assessment on Schedule A principles with evidence as to value, the learned Judge accepted their contention and remitted the case to the Commissioners.

The material part of Section 175 reads as follows:

"(1) If, as respects any year of assessment, the immediate lessor of a unit of assessment is entitled in respect of the unit to any rent payable under a lease or leases to which this section applies, he shall be chargeable to tax under Case VI of Schedule D in respect of the excess, if any, of the amount which would have been the amount of the assessment of the unit for the purposes of Schedule A, as reduced for the purpose of collection, if the annual value of the unit had been determined (in accordance, in whatever part of the United Kingdom the unit is situated, with the provisions of Part III of this Act) by reference to that rent and the other terms of the lease or leases, over whichever is the greater of—(a) the actual amount of the assessment of the unit for the purposes of Schedule A, as reduced for the purpose of collection; or (b) the amount of any rent payable by the immediate lessor in respect of the unit under any short lease or short leases."

The problem here is to find what is the amount which would have been the amount of the assessment for the purposes of Schedule A if the annual value had been determined "by reference to that rent and the other terms of the lease". "That rent" is the rent to which the lessor is entitled in the year in question, the rent whose excess over the Schedule A assessment has provoked the incidence of Section 175, namely, in this case £681. The opening words, "If, as respects any year of assessment," indicate that the Section envisages a yearly operation. The fact that the charge is under Case VI of Schedule D makes it clear that the assessment is aimed at a year's profit or gain.

According to the Respondents, the Section really does no more than provide for a revaluation of Schedule A assessments, and the resulting excess liability is only put into Case VI of Schedule D because that is a receptacle for oddments. It is said further that the resulting assessment would have to be an enquiry on Schedule A principles: namely, what the unit is worth to be let by the year having regard, not only to the rent of £681 received this year, but also "to the other terms of the lease" including the fact that there are several years of the lease to run. It is not disputed that this procedure will produce a different, and practically always a lower, figure than that produced by an assessment on the actual figure of the excess rent. In spite of Mr. Monroe's forceful argument, I cannot accept this view of the Section.

The Schedule A assessment under Section 82 of the Income Tax Act, 1952, is an attempt to find the annual value. If a rack rent has been fixed within

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the preceding seven years, then that is the annual value; if such a useful guide cannot be found, and the premises are not let at a rack rent so fixed, the enquiry is to ascertain the rack rent which the premises are worth to be let by the year. From a practical point of view, Section 175 comes into play because during the year in question there is an extra profit to be taxed and the rent to which the lessor has become entitled has shown the inadequacy of the Schedule A assessment; it has shown that either the actual rack rent or the estimate of the rack rent at which the premises are worth to be let by the year has produced an annual value that is incorrect for the year in question. The Section directs that the lessor shall be chargeable on the amount which would have been the Schedule A assessment if the annual value of the unit had been determined by reference to "that rent", namely, a rent of £681—that is, if the actual rack rent or the rack rent at which it is worth to be let had been £681. There is no need for further valuations or for calculations under Paragraph 2 (a) or 2 (b) of Schedule A in Section 82. The words "by reference to that rent" provide an *ad hoc* formula for the ascertainment of the annual value, a formula which excludes further estimation. The figure of £681 is, as it were, written into Section 82, or is a *tertium quid* to Paragraph 2 (a) and 2 (b). The case has to be considered as a Schedule A case only for the purpose of deductions and allowances. When Section 175 refers to the annual value being determined by reference to "that rent and the other terms of the lease", the "other terms" mean those which are relevant to allowances, such as liability for rates and maintenance.

The Master of the Rolls in argument pointed out that if the excess rent is lower than the rent at which the premises are worth to be let, as it well might be, the computation could not be made under Paragraph 2 (b) of Schedule A, as Mr. Monroe contends should be done in each case. For the computation has to be done by reference to "that rent", that is, the actual rent for the year, while Paragraph 2 (b) demands the computation of the rack rent at which they are worth to be let. In such a case a *tertium quid* is necessary in Paragraph 2, and that *tertium quid* must surely be the actual rack rent for the year in question, which is the objective of Section 175. It would be thus more analogous to Paragraph 2 (a), which uses a recent actual rack rent where it can be found.

It would be contrary to good sense that the Section, whose object was to ensure that certain actual profits did not go untaxed, should throw the assessment away from the realm of actual and exact figures, and back into the realm of estimation in which the profit had once already been allowed to escape. Seeing that the assessment under Section 175 is a yearly one, intended to catch a particular year's profit, it is hard to believe that it intended to send each case back to Schedule A in Section 82 for a valuation focussed not on the particular year but on a period of years, and calculated to assess

"what a tenant, taking one year with another, may fairly and reasonably be expected and required to pay"

(*per* Swinfen Eady, L.J., in *Gundry v. Dunham*, 7 T.C. 12, at page 22). Had such an odd result been intended, it would have been very easy to say so.

The normal case of excess rents is dealt with by direct calculation without a further assessment on Schedule A principles. For instance, in *Strick v. Longsdon*, 34 T.C. 528, the direct figures of the excess rents were used without embarking on further computation (except as to deductions). I see no reason why this case should differ from it. This view accords with that expressed by

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Lord Reid in a somewhat different context in *Littman v. Barron* (1), [1953] A.C. 96, at page 119, where he said:

"The calculation which Section 15 [now Section 175] directs is simply the method by which profits from the transaction are to be measured for income tax purposes and the assessment and charge to tax under the section are in respect of the profits so measured."

The point is not an easy one, but for these reasons I would allow the appeal.

Harman, L.J.—I agree. Section 175 is designed to deal with the injustice caused by the delay in reassessing freeholds under Schedule A. These assessments were intended to represent rack rents, but first they were allowed as a matter of convenience to run for a quinquennium and then, owing to the war, even these reassessments were pretermitted. Meanwhile, in a period of inflation, values were continually going up and landowners were more and more escaping from making a fair contribution to taxation. Hence Section 175, the object of which was to tax "excess rents". Excess over what? Over the out-of-date Schedule A values. It follows that one expects to find in the Section provisions designed to tax the difference between the existing Schedule A assessment and the rent actually being received. And this is what you do find, the words "that rent" being the actual rent receivable by the landlord in the year of assessment. The words are, slightly rearranging them: He shall be chargeable to tax under Case VI of Schedule D in respect of the excess over the actual Schedule A assessment of the amount which would have been the Schedule A assessment if the annual value of the unit had been determined by reference to that rent and the other terms of the lease. Note that this is a Schedule D assessment, and therefore not concerned with any but the one year in respect of which it is made. The reference to "the other terms of the lease" in my judgment refers to such things as covenants to repair, to pay rates and so forth, not to the "term" of the lease.

If this were all, there would be an injustice to the landlord, who would be unable to deduct from the actually receivable rent those allowances which Schedule A provides. Hence the reference to the hypothetical Schedule A assessment. This does not entail a new valuation; that is precluded by laying down "that rent" as the gross figure. The net figure is to be arrived at on Schedule A principles, that is, with the deductions and allowances which that Schedule prescribes, and will thus be truly comparable with the actual Schedule A figure which has undergone the same process. To postulate a new valuation—which ought, I should have thought, if properly done, to make no difference—is to my mind to reject the words "that rent", and is unjustified. If Mr. Monroe were right, the Section should simply have provided that wherever the receivable rent is in excess of the actual Schedule A assessment there shall be a new Schedule A assessment; and that it did not do.

Lord Evershed, M.R.—It has been agreed on both sides that the case before the Court falls within, and is governed by, Section 175 of the Income Tax Act, 1952. The question, therefore, is one of the interpretation, as applied to the facts of the case, of Section 175.

The Respondents here are

"entitled . . . to . . . rent payable under a lease . . . to which this section applies". They are therefore chargeable to tax under Case VI of Schedule D in respect of "the excess . . . of the amount which would have been the amount of the assessment of the unit for the purposes of Schedule A, as reduced for the purpose of

(1) 33 T.C. 373, at p. 409.

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collection, if the annual value of the unit had been determined (in accordance . . . with the provisions of Part III of this Act) by reference to that rent and the other [relevant] terms of the lease . . . over [in this case] the actual amount of the assessment of the unit for the purposes of Schedule A, as reduced for the purpose of collection",

viz., £10 15s. I have set out the material language, with the insertion of the word "relevant" before the phrase "terms of the lease" and of the figure of the actual amount of the Schedule A assessment; and I have emphasised in reading what appear to me to be the most important words.

It was conceded clearly, as I understood, by Mr. Monroe that the necessary calculation or reassessment has to be made every year—not, that is to say, notionally in 1946 or at the beginning or end of the tax year in question, 1953-54, and so as to persist for the whole period of the lease or for the period for which the actual assessment of £10 15s. lasts or for any other indefinite period. It also seems to me clear that what I will call the Schedule A reassessment, which the Section postulates as the "top figure" for the purposes of arriving at the subject-matter to be taxed, is to be based on the actual rent and other relevant terms of the lease, which I take to mean in this case the royalty provisions. You are therefore, in my view, not required in accordance with Schedule A in Section 82 of the Act to look for or discover a rack rent properly so called. For the purpose of the calculation which Section 175 requires, the rent plus royalty (in the present case) actually paid, or assumed, or contemplated as payable, takes the place of the rack rent. If the present lease provided for a rent (in the ordinary way) greater than the actual Schedule A assessment but less than the true rack rent, the lease rent would clearly, in my view, form the basis of the Schedule A reassessment and not the true rack rent. The result, in my view, is that, in spite of the reference in Section 175 to Part III of the Act, the case is outside the strict language of Schedule A, Paragraph 2. In other words, it is neither a Paragraph 2 (a) nor a Paragraph 2 (b) case, and in this respect, like my brethren, I have ventured to differ from Upjohn, J.

So far, as it seems to me, and as a result of the discussion before us, there is no real dispute between the parties. The sole issue appears to be this. The Crown say, You arrive each year at the top figure by reference solely to the actual rent and royalty figures for that year. The Respondents say, No; you arrive each year at a valuer's figure of annual value at the date of the valuation, based on the known facts as to rent and royalty but not arithmetically limited to the figures of rent and royalty for the year in question. Common sense at any rate seems to point to the two figures being the same. But there appears no doubt, from the fact that the case has come before us, and from what Mr. Monroe has said—and I therefore assume—that the Respondents' figure will in practice be found to be somewhat less than that based on the Crown's view. Which, then, is right? It is upon this matter that I confess to having felt greater difficulty than my brethren and to have doubted whether we should not prefer, as I understand the learned Judge did, the Respondents' method of assessment.

The reasons for my doubt are as follows. True, the relevant premises for the reassessment are the rent and royalty figures and not a rack rent, so that the case, as I have already stated, is neither a Paragraph 2 (a) nor a Paragraph 2 (b) case; still, apart from the substitution of these rent and royalty figures for the rack rent, you are directed by Section 175 to make your assessment in accordance with Part III of the Act. What is more, you are directed by Section 175 to arrive at your reassessment by determining the annual value of the unit; and this conception of "annual value" is, according to Section 82, inherent

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in all Schedule A assessments. If the rent under the present lease were a flat rent of £681 per annum, there being no royalties, there would of course be nothing in it; but if the rent were a flat rent but increasing (say) every three or five years, then I am not satisfied that you would not in any year work on the basis of an average for the term rather than upon the actual rent payable in any particular year: see *Commissioners of Inland Revenue v. Dickson's Executors*, 14 T.C. 69. If this is right, then it may be said that a similar principle of valuation should apply in the present case. I have also felt the force of the argument that the contrary view involves the result that you are construing Section 175 as though it had said that the "top figure" in any year was the actual sum received in that year for rent, including royalty, subject to the deduction appropriate to a Schedule A assessment; and the Section does not in terms so provide. You find instead the express reference to "annual value", which is of the essence of the Schedule A code. If this view were right, then the question that, in respect of the year 1953-54, the assessors would have to answer is: What is the annual value this year of this unit, according to Schedule A principles, on the basis that the rent it commands is the fixed rent and royalties payable now and henceforth according to the subsisting lease? In other words, the "top figure" would be arrived at by the Respondents' method of assessment.

This difficult and somewhat artificial case has required Section 175 of the Act to be applied to circumstances to which I cannot think it was ever intended to be applicable. I have therefore, and in deference to the view taken by the learned Judge, thought it right to express my doubt and my reason for it. But I have in the end thought that the claims of simplicity and common sense should prevail, and I am not therefore prepared to dissent from the clear conclusion at which my brethren have arrived. I agree with them that the appeal should be allowed.

Mr. Alan Orr.—My Lord, I ask that the appeal be allowed and the determination of the Commissioners restored, and I ask for an Order that the Respondents pay the Crown's costs in this Court and before Upjohn, J.

Harman, L.J.—What was the determination of the Commissioners? What did they say? It is a bit difficult to find out what they did say.

Mr. Orr.—It is at the very end of the Case Stated, my Lord. In paragraph 7 (2), they say:

"and this figure is the dead rent received, namely £35, plus the actual royalties received during the current tax year, £646".

Then in paragraph 8:

"We were subsequently informed that . . . a further assessment had been raised"

—and your Lordships will remember that—

"under Schedule A, which took account of the increased area"—

Lord Evershed, M.R.—Is £577 an agreed figure?

Mr. Orr.—Yes, my Lord; and I ask that that figure be restored.

Lord Evershed, M.R.—Why not say so? It is £577?

Mr. Orr.—Yes, my Lord.

Lord Evershed, M.R.—Mr. Orr, as you are on your feet, I should like to register my own disapproval of the form of Order made below:

"It is ordered that the case be remitted for them to adjust the assessments in accordance with the Judgment of the Court".

It is not right. The Order must be self-contained. I really think it is wrong. These things are so much a mystery that it may be that Counsel say it is beyond the Judge to understand what the Order should be, but you must try.

Mr. Orr.—I do appreciate what your Lordships are saying about that. I can only say that this form of Order, so far as I can discover, has been used for a long time.

Lord Evershed, M.R.—I suspect that is the trouble.

Mr. Orr.—I do not know of any case in which it has produced any difficulty.

Lord Evershed, M.R.—It is not right; and what you have just said I confess sounds very likely to be true: just because this has gone on in Revenue cases for the last century and a half, it has got to go on. It is time it was stopped.

Mr. Orr.—It will certainly be stopped.

Lord Evershed, M.R.—We also ask you to consider this—this is another matter—that to entitle an action “The Trustees of the (blank) Settled Estates”, if they are not a corporation sole or something, again is wrong.

Mr. Orr.—I find it impossible to say anything about that, my Lord.

Lord Evershed, M.R.—Would you please see that these things are not repeated out of sheer adherence to tradition?

Mr. Orr.—I am afraid it has been so in the past in this matter also.

Lord Evershed, M.R.—In this case, we agree the Commissioners’ determination must be restored, and you say the figure of £577 is agreed?

Mr. H. H. Monroe.—It is agreed, my Lord.

Lord Evershed, M.R.—Then what Mr. Orr suggests as to costs must be right, must it not?

Mr. Monroe.—I think it must, my Lord. I am instructed to ask your Lordships for leave to appeal to the House of Lords.

Harman, L.J.—How much is it worth to you—about 7s. 6d.?

Mr. Monroe.—I do not know how much it is worth to these Appellants, but I think it is only fair that I should say to your Lordships that these proceedings have been watched by a lot of other potential appellants with some interest.

Lord Evershed, M.R.—I hope they are not going to be allowed to do this for nothing, but it may be that it is not for me to enquire.

(The Court conferred.)

Lord Evershed, M.R.—Have the Crown anything to say about that?

Mr. Orr.—My Lord, I say nothing.

Lord Evershed, M.R.—Very well; we will give leave.

The Trustees having appealed against the above decision, the case came before the House of Lords (Viscount Kilmuir, L.C., and Lords Denning, Morris of Borth-y-Gest and Hodson) on 16th, 17th and 18th January, 1961, when judgment was reserved. On 13th February, 1961, judgment was given unanimously in favour of the Crown, with costs.

Mr. H. H. Monroe, Q.C., and Mr. R. Buchanan-Dunlop appeared as Counsel for the Trustees, and Mr. Roy Borneman, Q.C., and Mr. Alan Orr for the Crown.

Viscount Kilmuir, L.C. (read by Lord Denning).—My Lords, this is an appeal from an Order of the Court of Appeal (Lord Evershed, M.R., and Pearce and Harman, L.J.J.) allowing an appeal by the Crown from an Order of the High Court (Upjohn, J.) by which an appeal by the Appellants by way of Case Stated from a determination of the General Commissioners for the Drayton Division of Shropshire was allowed and the determination of those Commissioners was reversed.

The matter arises upon an assessment made upon the Appellants under Schedule D of the Income Tax Act, 1952, for the year of assessment 1953-54, and concerns surface rent and royalties received by the Appellants under a 21-year lease, granted by them in the year 1946, of certain land comprising a sandpit. Under the lease the tenants paid £10 a year rent and a royalty of 6*d.* per ton of sand taken from the land. There was also provision, of which in the event the tenants took advantage, for additional land to be taken on similar terms. The sandpit was assessed to tax under Schedule A for the first time for the year 1953-54, and the additional land taken over by the tenants was the subject of a separate assessment. It is not necessary for me to state the details. Royalties paid by the tenants rose steadily from £90 odd for the year 1946-47 to over £840 for the year 1952-53; for the year 1953-54 they were £646 1*s.*

Evidence was given before the General Commissioners by surveyors on behalf of the Appellants and the Crown respectively as to what would have been a reasonable fixed rent in respect of the original area of the sandpit together with the additional five acres for a 21-year lease from 25th March, 1946. Such reasonable rent was estimated by the Appellants' surveyor at £292 per annum and by the Crown's surveyor at £500 per annum, but both surveyors were of opinion that a sandpit would rarely be let at a fixed rent for a term of 21 years and that the only terms of letting which would be satisfactory to both landlord and tenant would be those adopted in the present case, namely, a small fixed rent and a royalty per ton of sand extracted. Both surveyors were agreed that, if required to estimate at the beginning of a year a fair annual value for occupation of the sandpit over the coming year (in accordance with the Crown's alternative contention), they would have to consider all the circumstances, including the results of the previous year's workings and the likely commercial demand for sand in the coming year, but that, in the absence of any significant change of circumstances, their valuation would not differ greatly from that shown by the previous year's working.

It is common ground between the parties that the rent and royalties fall within Section 175 of the Income Tax Act, 1952, which subjects what are commonly called "excess rents" to Income Tax under Case VI of Schedule D, and the question at issue in the appeal is whether, as the Crown contend, the Appellants are by the provisions of that Section assessable for the year of assessment on the basis of the rent and royalties actually received by them in that year, less the amount of the Schedule A assessment on the land and subject to such reduction as is allowable under Schedule A for the purpose of collection; or whether, as the Appellants contend, the Section on its true construction requires a computation to be made, in accordance with certain provisions applicable to Schedule A and having regard to the rent and royalties reserved by, and the other terms of, the lease, of the annual value of the land. It is common ground that such a computation would result in a different, and in almost all cases a lower, assessment than would be produced on the basis of the rent and royalties actually received in the year of assessment.

The history of Section 175 and its statutory ancestor, Section 15 of the

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Finance Act, 1940, is set out at length in the judgment of Upjohn, J.⁽¹⁾, and I need only make a short reference to it at this stage, adapting slightly the words of Lord Asquith of Bishopstone in *Barron v. Littman*⁽²⁾, [1953] A.C. 96, at page 122:

"The [old] system [of taxing under Schedule A only] worked fairly, so long as Schedule A value was frequently revised and so kept in step with commercial value. But when, during the war, quinquennial revaluations under this Schedule were suspended, an increasing disparity declared itself between the old Schedule A values and the rents which the premises in fact commanded in the market, and therewith an increasing tax-free commercial profit lodged in the hands of the entrepreneur. Section 15 of the Act of 1940 was clearly designed to 'catch' this profit."

It is, I think, convenient to split Section 175 (1) into the following parts:

A. "If, as respects any year of assessment, the immediate lessor of a unit of assessment is entitled in respect of the unit to any rent payable under a lease or leases to which this section applies".

By these words (a) one is instructed to look at the year of assessment, in this case 1953-54; (b) the lease in question is one to which this Section applies under Sub-section (4); (c) the Appellants are immediate lessors entitled to any rent payable under this lease.

B. "he shall be chargeable to tax under Case VI of Schedule D in respect of the excess, if any".

With regard to these words I note (a) that the assessment is under Case VI of Schedule D; (b) that it is in respect of an excess. The top line of the subtraction sum which gives the excess is derived from the formula in the Sub-section and the bottom line is the actual amount of the assessment for Schedule A as stated in paragraph (a) of the Sub-section,

C. "of the amount which would have been the amount of the assessment of the unit for the purposes of Schedule A, as reduced for the purpose of collection, if the annual value of the unit had been determined (in accordance, in whatever part of the United Kingdom the unit is situated, with the provisions of Part III of this Act) by reference to that rent and the other terms of the lease".

This is the formula, and it is essential to note—(a) That despite the reference to Schedule A the wording keeps one's view focussed on an annual value determined in accordance with the words which follow. One is taken away from the conception of an objective rack-rent to the term of the lease in question. This fits in with the need for determining not the market value of the land but the profit of the immediate lessor in question. (b) That the determination of the annual value of this Sub-section has two constituents: (i) It must be by reference to "that rent and the other terms of the lease". The words "that rent" refer back to "any rent payable under a lease" in the earlier part of the Sub-section. (ii) It must (in order to give effect to the words in brackets) be "in accordance . . . with the provisions of Part III of this Act".

From this analysis of the Sub-section it is, in my opinion, impossible to escape the following construction. First and foremost, one is directed to the year of assessment. Secondly, as might be expected in a Section the precondition of which is that a lessor should be entitled to rent, one proceeds to "that rent", in other words, the rent actually payable. This is emphasised by the fact that the words chosen are not "the terms of the lease including the rent" but "that rent and the other terms of the lease". Thirdly, having reached the figure of the rent actually paid one has to consider whether it is the true

(1) See page 460-1, *ante*.

(2) 33 T.C. 373, at p. 411.

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rent. At this point one must bear in mind the two constituents of the formula to which I have referred. In other words, one has to look at "the other terms of the lease", but "in accordance with the provisions of Part III of this Act". This means, in my view, that one has at this point to consider Section 86, which deals with tenants' rates, etc., paid by the landlord and owner-occupier, and Section 88, which is concerned with (*inter alia*) cases where the rent is not the true consideration but by reason of other terms of the lease an adjustment must be made. The fourth step is to make the reduction for collection, also in accordance with Part III of the Act. That is how the top line of the necessary subtraction sum is arrived at. This construction, which is that which appealed to Pearce and Harman, L.J.J., sends me to the actual payments made and conditions obtaining in this year of assessment. I have given full consideration to the view of Upjohn, J., that the Section uses the words

"the amount which would have been the amount of the assessment of the unit for the purposes of Schedule A",

and these predicate a notional figure. I have also considered the doubts of Lord Evershed, M.R., based on the use of "annual value". I do not, however, find that there is anything in the Section which drives one from reading the book to looking in the crystal, but, on the contrary, it is from beginning to end looking at the actualities of the year of assessment.

For these reasons I would dismiss the appeal.

Lord Denning.—My Lords, this case concerns a sandpit in Cheshire. In 1946 the owners let some two acres of it to a firm of builders' merchants for a term of 21 years. The rent payable was a surface rent of £10 a year for the two acres and a royalty of 6d. per ton on all sand worked and gotten from the land. The tenants covenanted that they would effectually and vigorously work and get the sand, unless it would be unprofitable on account of depression of trade or unless prevented by strikes and so forth. The royalties went up year by year from some £100 in 1947 to some £800 in 1952. By September, 1953, the tenants had got all the sand they could from the first two acres and thereupon became entitled under the lease to take up another five acres at an additional £25 a year surface rent. They took up these extra five acres and thenceforward paid £35 a year surface rent and a royalty of 6d. a ton. We do not know whether there was enough sand to last out the full term of 21 years or not.

We are only concerned with the tax payable by the owners for the year 1953-54. During that year from 1st April, 1953, to 31st March, 1954, the owners received a surface rent of £22 and royalties of £646, making £668 altogether. These two sums together are to be regarded as the rent: see *Reg. v. Westbrook* (1847), 10 Q.B. 178. The Schedule A figure for that period was only some £7, for it was apparently assessed on the agricultural value of the land. Both sides agree that the relevant Section is Section 175 of the Income Tax Act, 1952, which provides for a tax on excess rents; that is, roughly speaking, on rents which exceed the Schedule A figure. But the dispute is how the excess rent is to be calculated. The Crown say that it is to be calculated by reference to the *actual figure* of rent, namely, £668, received by the owners during the year in question. The owners say it is to be assessed by reference to an *estimate* of the annual value spread over the period of the lease.

The nature of the contest can best be seen by giving the actual figures. The Crown say that the amount chargeable to tax is £577, made up as follows:

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	£
Royalties actually received during the year 1st April, 1953, to 31st March, 1954	646
Surface rent actually received for the same period (apportioned for two acres from 1st April, 1953, to 29th September, 1953, and for seven acres from 29th September, 1953, to 31st March, 1954)	22
<hr style="width: 100%;"/>	
The rent received under the lease was therefore	668
This must be reduced by one-eighth for purposes of collection under Section 99	84
<hr style="width: 100%;"/>	
Leaving	584
Less Schedule A assessment on the land (apportioned for the acreage occupied during the year)	7
<hr style="width: 100%;"/>	
The excess rent chargeable under Section 175 is therefore ...	£577

The owners say that the Crown's assessment is wrong in taking the *actual* sum of £646 royalties received during the year. That figure, they say, should be replaced in the calculation by an *estimated* figure of the annual value. Mr. Monroe, for the owners, said that the Commissioners should be directed to find what was the consideration agreed to be paid under the lease and to express that consideration, in the light of evidence as to the amount of sand available and the rate at which it was likely to be used up, as a figure of annual value. By this I understand that, according to Mr. Monroe, the Commissioners should be directed to estimate the amount of sand to be gotten from the pit and see whether or not it was likely to be used up before the end of the 21 years. They should then estimate the royalties which the owners were likely to receive over the 21 years and then average it out so as to get a yearly figure. In short, they should spread the anticipated royalties over the period of the lease. Mr. Monroe said, however, that they could revise it in any particular year if circumstances required, as, for instance, if there was a depression in trade.

My Lords, I think that the Crown's contention is correct and the owners are wrong for the simple reason that the words of the Income Tax Act, 1952, compel this result. Section 175 compels you to take "that rent"—that is, the rent payable under the lease for the year of assessment—and to feed that rent into the Schedule A machine in this way. First, you take "that rent", that is, the actual rent, as the starting point. Secondly, you take "the other terms of the lease" and make such adjustments, if any, in that figure of rent as are warranted by Part III of the Act. For instance, if the landlord pays the rates, the figure must be reduced under Section 86; if the tenant does the repairs, the figure must be increased under Section 88(3)(b); and so forth. No such adjustments arise in the present case. Thirdly, you must deduct one-eighth, being the repairs allowance permitted "for the purpose of collection", under Section 99. The result of that calculation is to give you the top figure. Then, in order to ascertain "the excess" on which tax is chargeable, you do this. You take the "actual amount" of the Schedule A assessment (usually a low figure left over from the past), reduce it by one-eighth for the purpose of collection, then deduct it from the top figure, and you have "the excess" on which tax is chargeable under Case VI of Schedule D.

Mr. Monroe sought to escape from this result by minimising the impact of the words "that rent". He wished to read the Section as if it read that you

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must determine the annual value "by reference to the terms of the lease". Whereas it distinctly says that you must determine it "by reference to that rent and the other terms of the lease". "That rent" is clearly the actual figure. Mr. Monroe sought to support his argument by saying that injustice would result unless the Section was read in his way. He took two hypothetical cases: first, a lease for seven years granted for a *premium* of £700 and a rent of £100 a year; secondly, a lease for three years granted at a *rising rent* of £100 for the first year, £200 for the second year and £300 for the third year. Injustice, said Mr. Monroe, would result in those cases if the Schedule A figure was fixed at £200 and in addition "the excess" was calculated on the actual rent for the year of assessment.

My Lords, I am always ready, I hope, to look at any possible injustices said to be created by an Act of Parliament and to construe it, whenever possible, so as to remove them; for I take it that Parliament never intends to do an injustice to anyone. But I am quite unmoved by the possible injustices suggested by Mr. Monroe in this case. They are purely hypothetical and I doubt if they will ever arise in practice. If they should, there are ways and means, as Mr. Orr suggested, of overcoming them. On the other hand, I see every reason in common sense for taking the *actual* figure of rent and not resorting to an estimate; and that is what I think the Statute requires. I would therefore dismiss the appeal.

Lord Morris of Borth-y-Gest.—My Lords, the opening words of Section 175 of the Income Tax Act, 1952, show that from year to year a lessor may be chargeable to tax under Schedule D. He will be so chargeable in respect of any excess that in any one year there may be of one amount denoted by the words of the Section over another. In the present case no question arose as to the latter amount. It was the actual amount of the Schedule A assessment, as reduced for the purpose of collection. In order to arrive at the other amount denoted by the Section it has to be ascertained whether, in the particular year of assessment which is being considered, the lessor (the immediate lessor) was entitled to a rent which was payable under a lease to which the Section applies. When ascertained, that rent becomes an essential part of the determination or special calculation which the Section requires. The Section requires a determination as to what "would have been" the Schedule A assessment, as reduced for the purpose of collection, on a certain given basis. What would it have been if the annual value had been determined by reference to "that rent" and the other terms of the lease? The rent so referred to is, in my judgment, the actual rent for the year in question as ascertained. In the present case the lessors were entitled to a surface rent and to a royalty per ton "for all sand worked and gotten". The combined amount of the rent and royalty payments can be regarded as the rent payable.

When an assessment for the purposes of Schedule A is being made and the annual value of property is being ascertained, it has to be considered whether there has been a letting at a rack-rent fixed within a certain period, and if not what is the rack-rent at which the lands are worth to be let by the year. When the directions given in Section 175 are being followed, then enquiry has to take place as to what would have been the Schedule A assessment if the annual value had been determined, in accordance with the provisions of Part III of the Act, by reference to the actual rent payable to the lessor in the particular year of assessment and to the other terms of the lease. Instead, therefore, of determining the annual value by making an assessment or a valuation under Section 82, the figure actually payable to the lessor in the particular year is to be taken. Stated otherwise, if for the purposes of

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Schedule A the annual value had been determined by reference to the actual figure payable, then that actual figure would take the place of, or would be regarded as, the rack-rent. No occasion for any further valuation or calculation under Section 82 (2) (a) or (b) would arise. Section 175 also requires the supposition that annual value had been determined in accordance, in whatever part of the United Kingdom the unit of assessment is situated, with the provisions of Part III of the Act. This introduces the relevant provisions of Part III for determining assessments. Sections 86 and 88 may, for example, in particular cases, require consideration. Furthermore, Section 175, in directing the enquiry as to what, on the given basis, would have been the amount of the assessment of the unit for the purposes of Schedule A, uses also the words "as reduced for the purpose of collection". Such a reduction may be seen in Section 99. This being, as a matter of construction, my reading of Section 175, I add that this reading of it conforms with what must have been the object of the Section, which, broadly stated, was to impose an annual tax, being a tax under Schedule D, on differences between out-of-date Schedule A assessments and rents actually being received.

I would dismiss the appeal.

Lord Hodson.—My Lords, Section 175 of the Income Tax Act, 1952, repeats the language of Section 15 of the Finance Act, 1940, which was considered by your Lordships' House in *Littman v. Barron*, 33 T.C. 373. That case sustained the claim of the taxpayer to deduct losses suffered by him in respect of certain properties from excess rents chargeable under Section 15. All of their Lordships considered the operation of that Section. My noble and learned friend Lord Reid said, at page 408:

"... the provisions of Section 15 can be regarded as supplementary to Schedule A. But they are not an extension of Schedule A. They tax a new kind of profits or gains, and they tax it under Case VI of Schedule D because it does not come within the scope of any other Schedule or Case. Moreover, liability to pay tax under Section 15 is imposed directly on the lessor who makes the profit, whereas the occupier pays tax, at least in the first instance, under Schedule A. Section 15 imposes liability to tax if a notional revaluation of the property, based on the rent which the taxpayer actually receives, exceeds whichever is the greater of the actual Schedule A assessment or any rent which he has to pay under a short lease. Broadly speaking, that is a case where the taxpayer has made a profit by letting or sub-letting and where tax on the amount of his profit would exceed the tax due under Schedule A, or such part of that tax as he has to bear himself; and the amount of tax payable under Section 15 when added to the tax under Schedule A or that part of it which he bears himself will roughly correspond to what he would have had to pay in tax if he had had to pay nothing under Schedule A but had been taxed on his whole profit from letting or sub-letting the property."

Later, at page 409, Lord Reid said:

"The calculation which Section 15 directs is simply the method by which the profits from the transaction are to be measured for Income Tax purposes, and the assessment and charge to tax under the Section are in respect of the profits so measured."

True that the House was not concerned with how the notional revaluation, or, as it may be called, "the top figure", was to be calculated, but the language used supports the contention of the Crown that the calculation is to be made by reference to the actual figure of rent received by the taxpayer during the year in question.

The Appellants contended that the measure to be used is not the actual rent, including in this case royalties received, but the annual value computed by reference to the terms of the current lease. They argued that the figure of £646 (the royalties received during the year 1st April, 1953, to 31st March, 1954) is only relevant evidence to enable the annual value to be computed,

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and that the Commissioners should be directed to find what is the consideration agreed to be paid under the lease and to express that consideration, in the light of evidence as to sand available and the rate at which it is likely to be used up, as a figure of annual value.

The words of the Section, however, are in my opinion too strong for them. The Section provides a formula by which the excess rent is to be calculated. It begins by referring to the year of assessment and to "any rent" to which the lessor is entitled. This rent must be the sum of money payable as rent in respect of that year. The "top figure" is to be calculated by reference to "that rent and the other terms of the lease", but the calculation is to be made in accordance with the provisions of Part III of the Act. This means that such adjustments are to be made as are to be found in Part III of the Act, as, for example, provisions relating to repairs and payments of rates: see Sections 86 and 88 (3) (b) of the Act. Finally, by Section 99, a repairs allowance is permitted, as the result of which the assessment is for the purposes of collection reduced by one-eighth. The emphasis is on the word "rent"; "that rent" is the rent for the year of assessment, and there is no ground for treating the rent as one of the terms of the lease to be used only as evidence upon which a notional rent is to be fixed on a Schedule A basis. The words "other terms" cannot embrace rent for other years. The assessment is a Schedule D assessment under Case VI on profits or gains for the year of assessment, and the reference to Schedule A provisions is necessary in order that the taxpayer may not suffer the injustice of being deprived of any adjustments to which he should be entitled.

The Appellants sought to support their argument by the example of a case where the Crown's contention that the actual rent for the year is the basis of assessment would cause an injustice. If, it is said, one takes a lease for three years at a rent of £100 for the first, £200 for the second and £300 for the third year, the Schedule A assessment being £200, the landlord would, if directly assessed, pay tax on £100 excess rent in the third year, which on the face of it is unjust, since in the first year his actual rent was less by the same amount than the Schedule A figure on which he had to pay tax. Anomalies there must be, perhaps not infrequently, in tax cases, but I am not driven by this apparent anomaly to adopt the construction of Section 175 put forward by the Appellants.

I would dismiss the appeal.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

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

The Contents have it.

[Solicitors:—Peake & Co.; Solicitor of Inland Revenue.]
