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HIGH COURT OF JUSTICE (CHANCERY DIVISION)—  
12TH, 13TH AND 17TH DECEMBER 1963

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B

COURT OF APPEAL—4TH, 5TH AND 8TH JUNE 1964

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HOUSE OF LORDS—15TH, 16TH, 17TH, 21ST, 22ND AND 23RD JUNE  
AND 27TH JULY 1965

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**Strick (H.M. Inspector of Taxes) v. Regent Oil Co. Ltd.<sup>(1)</sup>**  
**Commissioners of Inland Revenue v. Regent Oil Co. Ltd.**

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*Income tax, Schedule D—Profits tax—Deduction—Oil dealing company—Exclusivity agreement with retailers—Premises leased from retailer and sublet to him—Whether premium for lease paid on capital or revenue account—Income Tax Act 1952 (15 & 16 Geo. 6 & 1 Eliz. 2, c. 10), s. 137(f).*

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*The Respondent Company's main business consisted in importing oil and selling it to garages and service stations. In the years to 31st December 1956 and 31st December 1959 it entered into agreements with certain retailers who were prepared to sell its products exclusively, in the form that the retailer, in consideration of a lump sum premium based on the amount of oil expected to be sold, leased his filling station to the Company for a term of years at a nominal rent, and the Company sublet the station back to the retailer at a nominal rent for the same period less three days. The sublease contained covenants binding the retailer to continue to take all his supplies of oil from the Company and to continue to carry on business at the station.*

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*On appeal against assessments to income tax under Case I of Schedule D for the years 1957–58 and 1960–61, and to profits tax for the corresponding chargeable accounting periods, the Company contended that the premiums were properly chargeable to revenue and were deductible in computing profits for tax purposes. The Crown contended that the premiums were paid for the acquisition of an interest in land, and since the Company was not a dealer in land they were of a capital nature and not deductible. The Special Commissioners held that the payments were of a revenue nature.*

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*Held, that the payments could not be allowed as revenue outgoings.*

*Bolam v. Regent Oil Co. Ltd. (1956) 37 T.C. 56 distinguished.*

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<sup>(1)</sup> Reported (Ch. D.) [1964] 1 W.L.R. 309; 108 S.J. 54; [1964] 1 All E.R. 585; 235 L.T. Jo. 123; (C.A.) [1964] 1 W.L.R. 1166; 108 S.J. 500; [1964] 3 All E.R. 23; 235 L.T. Jo. 415; (H.L.) [1966] A.C.295; [1965] 3 W.L.R. 636; 109 S.J. 633; [1965] 3 All E.R. 174; 236 L.T. Jo. 485.

## CASES

A

(1) *Strick (H.M. Inspector of Taxes) v. Regent Oil Co. Ltd.*

## CASE

Stated under the Income Tax Act 1952, s. 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

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1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 10th, 11th and 12th December 1962, Regent Oil Co. Ltd. (hereinafter called "Regent") appealed against assessments made upon it under Case I of Schedule D of the Income Tax Act 1952 for the years 1957-58 and 1960-61 as a dealer in oil in the respective sums of £1,600 and £500,000. The question for our decision was whether Regent was entitled to deduct, in computing its profits as a dealer in oil, certain payments made to retailers in the circumstances hereinafter appearing, or whether such payments were (as the Crown contended) of a capital nature the deduction of which is prohibited by s. 137(f) of the Income Tax Act 1952. (It was admitted on behalf of the Crown that they were made wholly and exclusively for the purpose of Regent's trade, and that accordingly the deduction of these payments was not prohibited by s. 137(a).)

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2. Regent's main business consisted in importing oil and selling it to garages and service stations (known in the trade as "outlets" but hereinafter referred to as "stations") which in turn resold such oil to the public. From 1950 onwards it had been forced to take part in a struggle with its two main competitors to obtain agreements with the owners of stations which would sell its products exclusively, making therefor what were termed "exclusivity" payments to the owners of such stations. The right to deduct certain of such payments for years previous to those now under appeal, namely, the years to December 1951, 1952 and 1953, was the subject of a previous appeal to the Special Commissioners and from their decision by way of Case Stated to the High Court: see *Bolam v. Regent Oil Co. Ltd.* (1956) 37 T.C. 56. The Case stated by the Special Commissioners in that appeal contains in paragraphs 4 to 15 a full account of the early history of what may be termed the "exclusivity war" between the three major oil companies, and it was agreed between the parties that the facts therein stated together with exhibits "A", "C" and "D" therein referred to were material to the present appeal. (The said exhibits, which are not printed in Tax Cases, are available for inspection by the Court if required.) To save repetition and expense such facts are not repeated herein; but they were admitted as such and the attention of the Court is directed to them as preliminary to those stated in the next succeeding paragraphs. The present appeal is concerned with certain "exclusivity" payments made by Regent to retailers in subsequent years, namely, the years to 31st December 1956 and 31st December 1959, and details of such payments and of the circumstances in which they were made appear in the succeeding paras. 3 to 12.

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3. As the years went by the "exclusivity war" intensified, and Regent was compelled to make payments to retailers in a form increasingly favourable to them in order to retain its stations, since its rivals made tempting offers to retailers whose contracts with Regent were about to expire in order to obtain such stations for themselves. Regent was not entirely successful, even with such new form of payments, in holding on to its previous share of the market:

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A there is attached hereto, marked "A"<sup>(1)</sup>, a statement showing the percentage that Regent's sales of motor spirit bore to the total sales in the United Kingdom. It will be seen that such percentage declined from 14 per cent. in 1955 to 12 per cent. in 1961.

B 4. The form of payments to retailers with which the present case is concerned is that arising from a transaction of lease and sublease. Retailers were no longer content with payments to them of sums year by year calculated on gallonage sold; they demanded to be paid lump sums in advance, although these lump sums were still calculated by reference to the gallonage which it was anticipated would be sold at the station concerned. Retailers were also anxious that any payment received by them should if possible take a non-taxable form. To achieve these objects the transaction took a new and somewhat peculiar form: the retailer leased his entire station to Regent for a term of years at a nominal rent in return for the desired lump sum expressed as a premium, and simultaneously Regent leased the station back to the retailer at a nominal rent for the same term of years less three days. The sublease by Regent to the retailer contained, in addition to the clauses for payment of rent and for repair usual in a lease, clauses binding the retailer to take all his supplies of oil from Regent and to continue to carry on business at the station. There was also a proviso for re-entry in the case of any breach of covenant by the dealer, which it was hoped might prove of advantage to Regent in the event of the dealer getting into financial difficulties or wishing to assign to another dealer, by preserving the station for Regent, and it was recognised by Regent that in this respect the lease and sublease transaction gave it somewhat greater security than the old type of sales agreement, but the validity as against a receiver or liquidator of the proviso for re-entry was regarded as somewhat uncertain. (Details of the old type of payment appear, as will have been noted, in para. 9 and exhibit "C" of the previous Case Stated<sup>(2)</sup>. It is hereinafter referred to as the "old sales agreement".)

F 5. An example of the new kind of transaction is that between Regent and Green Ace Motors Ltd., of Ipswich. Green Ace Motors in 1956 declined to renew an old sales agreement with Regent, and Green Ace Motors proposed that they should be treated on the lease and sublease basis just described. A copy of the lease by Green Ace Motors Ltd. to Regent and a sublease by Regent back to Green Ace Motors Ltd. are hereto annexed, marked "B" and "C" respectively<sup>(1)</sup>. The sum of £5,000 paid by Regent to Green Ace as premium for the lease was calculated by reference to the gallonage which it was expected would be sold at the station during the currency of the sublease. At the commencement of the exclusivity war the oil companies were paying a rebate of  $\frac{1}{4}d.$  per gallon in return for exclusivity. In 1956, when the Green Ace transaction was entered into, the amount had risen to  $1d.$ , and the premium of £5,000 paid by Regent to Green Ace was calculated at  $1d.$  per gallon on an anticipated sale of 1,200,000 gallons at that station for the period of the sublease. If less was sold the retailer did not have to repay anything, but if more was sold he was to get  $1d.$  per gallon on the extra amount. This extra amount was provided for by an agreement, a copy of which is hereto annexed, marked "D"<sup>(1)</sup>, between Regent and Green Ace executed at the same time as the lease and sublease. The extra amount is described in the agreement as a rebate in the purchase price of the oil.

<sup>(1)</sup> Not included in the present print.

<sup>(2)</sup> Bolam v. Regent Oil Co. Ltd. 37 T.C. 56.

6. A similar transaction of the lease and sublease type was entered into by Regent with one of its leading retailers, C. V. Clapp Ltd. of Bristol (hereinafter called "Clapps"). By the time that Clapps' old type of sales agreement had expired one of Regent's competitors offered Clapps a lease and sublease agreement, and Regent had to match its offer to keep the station. The only differences between the Clapps and the Green Ace transaction detailed in the last paragraph were that, as the amount of oil likely to be sold at Clapps' station could be accurately assessed, there was no supplementary agreement for any payment by Regent beyond the premium for the lease, which was based on anticipated sales, and also that the security offered to Regent by the sublease was somewhat better than in the Green Ace transaction in that, before assigning the sublease or subletting, Clapps had to offer to surrender the sublease to Regent, and there was to be no assignment or subletting (if Regent did not accept the surrender) unless Clapps procured an undertaking by the intended assignee or sublessee to be bound by the terms of the sublease. These provisions relating to assignment and subletting are contained in subclauses (15) and (16) of clause 2 of the sublease, which are similar to subclauses (18) omitting para. (a) and (19) of the draft sublease in the Modern Motors transaction, exhibit "F" below<sup>(1)</sup>. These clauses had been drafted for Regent, by counsel specialising in landlord and tenant matters, in 1952 or 1953, for use when Regent owned a station and wished to let a tenant into possession to run it. Regent's solicitor inserted the provisions because they had become standard form in leases granted by Regent. Para. (a) of clause 2(18) was peculiar to the Modern Motors transactions. Copies of the lease and sublease in this case are available to the Court if required.

7. The next group of payments to which the present appeal relates were made to a group of companies controlled by John Murphy. He was a building contractor who owned or was able to obtain a number of sites suitable for petrol stations and wished to go into the petrol selling business. He had already been approached by one of Regent's competitors who offered him financial assistance in the form of a lease and sublease agreement, but Regent was able to persuade him through a friend to accept assistance from Regent in the same form, upon which he was insistent. In the first place agreement was reached with regard to four sites in south-east London, and the agreement was subsequently extended to eleven other sites. Particulars of the agreement reached are contained in letters passing between Regent and Mr. Murphy dated 30th April 1959, 20th May 1959 and 22nd May 1959, copies of which are hereto annexed in a bundle marked "E"<sup>(1)</sup>. It will be seen that the transactions were to take the same lease and sublease form as those already described; that the lump sum to be paid by Regent was based as before on the gallonage which was expected to be sold at each station; that there was to be further payment by Regent if more than expected was sold but an extension of the lease to Regent if less than expected was sold. Mr. Murphy formed companies, in which he and his wife held substantially all the shares, to take over the various sites which he owned, and the formal leases and subleases provided for by the above agreement were ultimately entered into by the respective companies and Regent. As a specimen of the transactions there is annexed hereto, marked "F"<sup>(1)</sup>, a bundle containing, firstly, an agreement between Modern Motors (Hackney Road) Ltd. ("Modern Motors") and Regent providing for the building of a garage on the site, which was held by Modern Motors for a term of 22 years, secondly, a draft lease of such garage by Modern Motors, when built, to Regent for the term of 21

<sup>(1)</sup> Not included in the present print.

A years, and thirdly a draft sublease by Regent to Modern Motors for 21 years less three days. The consideration payable by Regent to Modern Motors was to be £27,000, of which £21,600 had already been advanced by Regent on the security of the site held on lease by Modern Motors. In due course a lease and sublease in the form of the drafts were duly executed. Mr. and Mrs. Murphy joined as guarantors on behalf of J. Murphy Ltd. The said lease and sublease  
 B carried out and put into effect the terms of the agreement (exhibit "E"<sup>(1)</sup>) come to between Regent and Mr. Murphy so far as that site was concerned, and the sublease contained covenants and other terms designed to preserve the station in the event of Modern Motors wishing to assign or going out of business. The variation in the lump sum paid or to be paid to Modern Motors according to the amount of oil sold at the station for which the agreement  
 C provided was also inserted as terms of the lease and sublease. In due course such leases and subleases were granted, and lump sums paid by Regent to the respective companies in respect of the other thirteen sites referred to.

8. The remaining transaction is concerned with a station called the Stadium Motor Works in Belfast. This belonged to a Mr. and Mrs. Smyth, and in 1956 Regent entered into an old sales agreement with them which was to run for five years, i.e., until 1961. Early in 1959, however, one of Regent's competitors tried  
 D to get hold of the station for themselves by offering the Smyths an attractive rent. The Smyths, however, did not want to go out of business themselves, and suggested to Regent a fresh agreement on a lease and sublease basis. After discussion of the probable gallonage to be sold from the station a bargain was worked out on a basis of 100,000 gallons a year for 20 years. At a rebate of 1d.  
 E per gallon this worked out at £8,333 to be paid, but the Smyths were getting nearly  $1\frac{1}{4}d.$  per gallon under the old sales agreement, so an additional payment was agreed of  $\frac{1}{4}d.$  on each gallon sold to be paid year by year and  $1\frac{1}{4}d.$  per gallon on every gallon sold over the estimated amount of 100,000 gallons. At the last minute Mr. Smyth asked for and obtained slightly better terms in that he was  
 F to be paid the full  $1\frac{1}{4}d.$  per gallon on the estimated gallonage (amounting to £10,416) instead of the extra  $\frac{1}{4}d.$  being paid annually. In due course these terms were implemented by the Smyths granting a lease and Regent granting a sublease in the way already described. The sublease contained in clause 2(18) a provision against subletting without consent save in the case of assignment to the lessee's son Samuel N. Smyth; clause 2(19) was the standard form relating to a deed of licence, as in clause 2(19) of the Modern Motors transactions; clause 3 provided for re-entry in case of the lessee's bankruptcy or  
 G breach or non-observance of the lessee's covenants. Copies of such lease and sublease are available for inspection by the Court if required.

9. The payments and periods of lease in question relating to the two years under appeal were as follows:

H Assessment year 1957-58 (Regent's accounts to December 1956) £5,000 paid in Green Ace transaction (10-year lease).

Assessment year 1960-61 (Regent's accounts to December 1959) £10,416 paid to the Smyths (21-year lease); £183,200 paid in respect of the six Modern Motors transactions (21-year lease); £2,083 paid to Clapps (5-year lease).

<sup>(1)</sup> Not included in the present print.

10. The above transactions by way of lease and sublease were the only ones of their nature in respect of which payments were made in the relevant years; their scope and importance in relation to Regent's trade in oil at the time can be seen from the following particulars: A

(a) In the year 1956 Regent oil was sold at 4,886 stations. Of these 4,483 stations were "tied" to Regent, i.e. 91·7 per cent. of the total number. Of the 4,483 "tied" stations about twelve were tied by means of the lease and sublease method. (Payments, however, were not made to all twelve in the year.) B

(b) In the year 1959 out of a total of 4,682 stations 4,300 were tied, and about the same number as in 1956 (i.e. twelve) were tied by lease and sublease. The exact number of such lease and sublease stations in each year was not proved.

(c) The officials of Regent preferred the old sales agreements to the lease and sublease agreements, despite the somewhat greater security which it was hoped would ensue from the latter. They regarded the lease and sublease procedure, which was forced on them by retailers, with some distaste because of its novel and highly artificial nature. C

11. In a number of cases Regent had been able to purchase a station outright and to let it to a dealer of its choice on its own terms. This method of acquiring a "tie" was the one most preferred, but good sites were difficult to acquire outright. Where this was done the payments made for the land were admitted by Regent to be of a capital nature. D

12. The payments to retailers to obtain and retain the exclusive sale of Regent's oil at a given station have always been included as debit items in the profit and loss accounts of Regent. Payments under the old sales agreements appeared under the heading "Customer equipment and display expenditure". The premiums paid under the lease and sublease procedure, together with any additional rebate paid in respect of extra gallonage, appeared as a deduction in arriving at sales revenue. Auditors and accountancy advisers of Regent who gave evidence before us took the view that such payments were made to preserve turnover, that no fresh asset was acquired as a result of such payments, and that accordingly such payments were properly chargeable to revenue. E F

13. It was contended on behalf of Regent that the payments in question made under the lease and sublease procedure were properly chargeable to revenue, and were deductible in computing Regent's profits for the purposes of income tax.

14. It was contended on behalf of H.M. Inspector of Taxes: G

(1) that the said payments were premiums for leases by payment of which Regent acquired interests in land;

(2) that, Regent being a dealer in oil and not in land, the said payments were not of a revenue character;

(3) that each of the said payments was a capital payment and was not properly deductible in computing Regent's profits for income tax purposes. H

15. We, the Commissioners who heard the appeal, held that the payments in question were of a revenue nature. We were of opinion that they could not simply be treated for tax purposes as rebates on the price of oil sold, although in all cases they were calculated by reference to the amount of oil expected to be sold in a given period at the station concerned. They were properly described in the leases as premiums, and must be treated as such. On the other hand, it would in our view be quite wrong to limit our consideration to the I

- A leases, and to regard Regent as having acquired by the payments in question interests in land which were in view of the authorities necessarily of a capital nature. There was in each case an obligation binding on Regent to grant a sublease back to the lessor simultaneously with the obtaining of the lease, such sublease being for practically the same term as the lease and at a nominal rent. There was therefore no time at which Regent was in possession of an
- B unfettered (and consequently valuable) interest in land. At the end and as a result of the two transactions of lease and sublease, which were firmly linked together, Regent had paid a sum of money for a valuable right, namely, the exclusive right to have its oil sold at the station for a given period. There was at least a good chance that such right would be preserved even if the sublessee got into financial difficulties or wished to give up business and assign its sub-
- C lease, because the clauses of the sublease were designed to protect Regent in such an event. Regent had therefore acquired by means of the payments rights of some value, but the question remained could such rights be properly described as "assets or advantages for the enduring benefit" of Regent's trade (to apply the test to be found in *Atherton v. British Insulated and Helsby Cables Ltd.*<sup>(1)</sup> 10 T.C. 155, at page 192)? Again, to apply the test to be found in *Van den Berghs Ltd. v. Clark*<sup>(2)</sup> 19 T.C. 390, at page 431, were the several transactions with retailers "ordinary commercial contracts made in the course of carrying on [Regent's] trade . . . contracts for the disposal of their products . . ." or did such contracts, on the contrary, "relate to the whole structure of [Regent's] profit-making apparatus"? In our opinion these questions had to be answered having regard to the whole nature, extent and scope of Regent's trade,
- E including the fact that the payments in question were not expected to secure an increase in Regent's share of the oil trade but only to maintain it. What might be an enduring advantage in the case of a company with a small and limited turnover would probably be an insignificant matter in the case of a company with a worldwide or nation-wide trade. Moreover, the several transactions and the payments under review could not in our view (and we understood this was
- F admitted) be aggregated in considering the questions in issue: such questions must be answered separately with regard to each transaction. It was therefore a question of degree, and, having regard to all the known features and extent of Regent's trade, to the amounts paid under the various transactions, to the length of time the benefits were to endure, to the degree of security obtained by Regent, and to all the other circumstances proved before us, we held that
- G the payments in question were properly to be treated as of a revenue and not of a capital nature.

We left figures to be agreed in accordance with our decision. Figures were agreed on 15th February 1963, and on 4th March 1963 we adjusted the assessments as follows:

1957-58 assessment increased to £8,984 (capital allowances £8,984)

- H 1960-61 assessment increased to £1,078,499 (capital allowances £884,975).

16. H.M. Inspector of Taxes immediately after the determination of the appeal declared to us his 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 Income Tax Act 1952, s. 64, which Case we have stated and do sign accordingly.

<sup>(1)</sup> [1926] A.C. 205.

<sup>(2)</sup> [1935] A.C. 431.

17. The question for the opinion of the Court is whether upon the facts found or admitted our decision was correct in law. A

B. Todd-Jones	}	Commissioners for the Special Purposes of the Income Tax Acts.
F. Gilbert		

Turnstile House,  
94-99 High Holborn,  
London, W.C.1.  
17th July 1963.

B

(2) *Commissioners of Inland Revenue v. Regent Oil Co. Ltd.*

This Case related to assessments to profits tax for the chargeable accounting periods ending 31st March 1956, 31st December 1956, and 31st December 1959. C

The facts, the contentions of the parties and the decision of the Commissioners were the same as those in the first case.

The cases came before Pennycuick J. in the Chancery Division on 12th and 13th December 1963, when judgment was reserved. On 17th December 1963 judgment was given in favour of the Crown, with costs.

*H. H. Monroe Q.C.* and *J. Raymond Phillips* for the Crown. D

*Roy Borneman Q.C.* and *Stewart T. Bates* for the Company.

**Pennycuick J.**—This is an appeal by the Crown against the decision of the Special Commissioners allowing appeals by Regent Oil Co. Ltd. (to which I shall refer as “Regent”) against assessments upon it under Case I of Schedule D for the years 1957-58 and 1960-61 as a dealer in oil. The question is whether, in computing its profits, Regent is entitled to deduct certain payments described as premiums paid to proprietors of service stations, or whether such payments are of a capital nature. The deduction of payments of a capital nature falls within the express prohibition contained in s. 137(f) of the Income Tax Act 1952, as being any sum employed as capital in such trade. The payments are admittedly payments made within the course of Regent’s trade. E

Regent’s trade consists of the import of oil and its sale to service stations, which resell to the public. The great proportion of this trade is in the hands of three groups of importers—namely, Esso, Shell and Regent; Regent’s proportion of the whole having varied between 11 and 14 per cent. over the past eight years. After the end of petrol rationing and the return of branded petrol, Esso and Shell initiated a policy known as “exclusivity”. This policy involved making arrangements with the proprietors of service stations under which the latter agreed for a consideration to sell exclusively the products of the importer concerned. Regent found itself obliged to adopt a similar policy, and evolved, in or about 1950 or 1951, what was known as the Regent Solus Dealer Plan. The basic scheme of agreement under this plan was that Regent should pay the customer a sum calculated by reference to the estimated gallonage to be supplied by Regent to the customer over a specified period, and that F  
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(Pennycuik J.)

A the customer should undertake, during this period, to buy from Regent his total requirements of motor fuel. As time went on, the customers appear to have become increasingly demanding, and it became a regular practice to make agreements for terms extending up to five or six years, the whole amount payable by Regent being none the less paid in a lump sum on the signature of the agreement.

B In 1955, the Inland Revenue challenged payments of these lump sums as being capital expenditure. The Special Commissioners allowed Regent's appeal, and their decision was upheld by Danckwerts J. in *Bolam v. Regent Oil Co. Ltd.* (1956) 37 T.C. 56. I will read the concluding passage in the judgment (at pages 67-8):

C "My attention has been called to a number of authorities which establish, no doubt, that the mere fact that there are large numbers of transactions of a similar kind does not make the expenditure on those transactions part of the current expenditure of the taxpayer deductible for the purposes of Income Tax. That, no doubt, is perfectly correct, but it may be a factor, I should have thought, in reaching the right conclusion. Secondly, the authorities establish, and notably those cases in regard to the payment of premiums in connection with leases of property, that you may do a transaction in one way which will enable the taxpayer to deduct the expenditure, and yet carry out in substance the same transaction by a different method which will unfortunately prevent the taxpayer from deducting what he pays if he pays a lump sum in the nature of premium. My attention has also been directed to the principle which is stated in cases like *Atherton v. British Insulated and Helsby Cables, Ltd.*, 10 T.C. 155; *United Steel Companies, Ltd. v. Cullington*, 23 T.C. 71; and *Associated Portland Cement Manufacturers, Ltd. v. Kerr*, 27 T.C. 103, which do establish that principle (for which, of course, the Inspector of Taxes was contending in the present case) that you may have a payment which is plainly of a capital nature because it is for the purpose of securing some permanent advantages which will enable the trader to earn his profits in his trade, and that may be a capital payment and the acquisition of a permanent asset, and cannot, therefore be charged to current expenditure. But in this case it seems to me that it is disregarding the nature of the transactions from the facts of the case to say that that principle applies here. It seems to me that there would have been no doubt if the payments had been made by reference to the amount of petrol sold to the retailers in each year; it would plainly have been expenditure, particularly if paid in the form of a rebate, which was expended by the Regent Oil Co. in the course of its trade in the making of its profits. Does it make a difference because in the circumstances of the case there has to be some lump sum fixed which is paid to secure the same result, and even if payment is made in advance for several years? I apprehend, for instance, in the case of a lease, if the lease were to be agreed and then the whole of the rent payable was paid in one sum for five or six years ahead, it would nonetheless still retain its nature of payment of rent, and would be a current expenditure of the person making the payment and not necessarily an acquisition of a capital asset. In these cases it is sometimes very difficult to see where the line comes, but I am satisfied in the present case that the line comes on the other side from that of capital expenditure. It seems to me that this expenditure adopted by reason of the policy of the competitors of the

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(Pennycuik J.)

Regent Oil Co., was an expense which the trading company, the Regent Oil Co., had to incur from time to time in order to earn its profits, and in the course of earning those profits. Therefore, it seems to me that the Commissioners reached the right conclusion in holding that it was expenditure of a nature which was deductible.” A

Since the decision in that case, Regent has in the main attempted to make agreements of the character there considered, and as to payments under such agreements no question arises. Regent has, however, in a small number of cases, adopted, at the instance of the customers concerned, a different type of arrangement. In 1956, Regent oil was sold at 4,886 stations, of which 4,483 were tied, but only 12 by the new type of arrangement. The new type of arrangement consists, in essence, of the following transaction. (1) The customer, in consideration of a lump sum described as a premium, lets the filling station to Regent for a term of years at a nominal rent. The premium is calculated by reference to the estimated gallonage to be supplied by Regent to the customer—e.g., 1*d.* per gallon. Regent agrees to make additional payments if this gallonage is exceeded. (2) Immediately upon the execution of the lease, Regent sublets the station back to the customer for the same term less three days at a nominal rent, and the customer enters into covenants to use the premises as a station, to use exclusively Regent’s products, and not to assign except in favour of an assignee undertaking to enter into similar covenants. B C D

The present appeal is concerned with four such agreements, these being made with Green Ace Motors Ltd.; C. V. Clapp Ltd.; Mr. & Mrs. Smyth, of Stadium Motor Works, Belfast; and Mr. Murphy, on behalf of Modern Motors Ltd. The arrangement with Green Ace Motors is a simple example of the type outlined above. The precise terms of the sublease are important, and I must read some of them in full. E

The sublease is made between Regent and Green Ace Motors Ltd., and it witnesses that, in consideration of the rent and covenants thereafter contained, Regent demises the specified premises to the dealer for the term of ten years less three days at the yearly rent of £1. Then: F

“The Dealer hereby covenants with the Company [Regent] in manner following, that is to say”,

and there follow certain usual covenants for the payment of rent, repairs, insurance and the like. Then follow these covenants. Clause 2:

“(6) Not to assign underlet or part with or share the possession of the said premises or any part thereof without previously obtaining the consent thereto of the Company in writing Provided Always that such consent shall not be unreasonably withheld in the case of an assignment underletting or parting with or sharing possession to or with a respectable and responsible person who undertakes by direct covenant with the Company to perform and observe the Dealer’s obligations under sub-clause (7) of this Clause.(7) That throughout the said term the Dealer: (a) will at all times carry on upon the said premises and will not for any period or periods of time discontinue either wholly or in part the business of a garage and petrol filling station as at present carried on and will ensure that during reasonable business hours the Company’s brands of motor fuel are available for sale at the said premises to the public (b) will for so long as and whenever the Company is willing and able to supply the Dealer with such motor fuel and other light products as the Company is for the G H I

(Pennycuick J.)

- A time being distributing generally for sale to the public purchase its total requirements of motor fuel and other light products from the Company at the Company's standard bulk wholesale price applicable on the day of each delivery for resale at the said premises . . . (c) will not for so long as aforesaid sell at the said premises or at any adjoining premises owned or occupied by the Dealer any motor fuel or other light products supplied
- B by any Company person or firm other than the Company (d) will for so long as aforesaid permit the Company to place and maintain its globes upon all the petrol pumps on the said premises to denote that the products to be delivered therefrom are supplied by the Company and to lock and seal the tanks connected to the said pumps and will not interfere with disconnect remove or obscure such locks seals or globes or the pipe fittings connecting the said pumps to the tanks . . . (f) will not for so long as aforesaid permit any pump globes or other advertising matter to be displayed at the said premises or at any adjoining premises owned or occupied by the Dealer relating to the motor fuel other light products or lubricants of any company person or firm other than the Company except in the case of lubricating oils reasonable indication of the make and grade of oil supplied (g) will not for so long as aforesaid without the prior consent of the Company make any reduction in the number of pumps in use for the retail sale of motor fuel to the public or make any other alteration in the arrangements for selling motor fuel . . . (h) will not without the prior consent in writing of the Company carry on upon the said premises any trade or business other than that of a garage and petrol filling station".

- E Then, in clause 3, there is a proviso for forfeiture in the event of the dealer committing an act of bankruptcy or going into liquidation,

"or if and whenever there shall be a breach of non-observance of any of the covenants by the Dealer hereinbefore contained".

Annexed to the lease and sublease there is a separate document whereby Regent, in consideration of the completion of the lease and sublease, undertakes that if, during the term of ten years, Green Ace Motors

- F takes that if, during the term of ten years, Green Ace Motors

"shall purchase for resale at the said property an aggregate quantity of motor fuel in excess of"

the specified amount, Regent will, during the remainder of the term, pay to Green Ace Motors, or allow them by way of rebate, the sum of 1*d.* per gallon of motor fuel actually purchased in excess of the specified amount, such payment to be a reimbursement against sales expenses as thereafter defined.

- G The arrangements with Clapps and the Smyths differ in detail, but it is not suggested that these differences have any relevance for present purposes, and I need not refer to them again. The arrangement with Modern Motors Ltd. is different in that, at the date of the agreement with that company, it was engaged in the erection of a number of stations, and a lump sum is expressed to be payable in consideration of the company undertaking to erect each of the stations and to grant leases on the scheduled terms. In these four instances, the premiums ranged from £2,083 to Clapps, £5,000 to Green Ace Motors, £10,416 to the Smyths, up to £183,200 in the case of Modern Motors' six stations. The terms ranged from five years with Clapps, ten years with Green Ace, to 21 years with the Smyths and Modern Motors.

- I It is clear, and not in dispute, that in each case the lease and sublease—and, of course, the supplemental document—form a single transaction.

**(Pennycuick J.)**

Regent therefore receives in return for the premium (1) the interest under the head lease and (2) the customer's covenants under the sublease. The Crown contended that the premium is a payment for the acquisition of a capital asset; Regent contended, and the Special Commissioners held, that the premium is an outgoing properly chargeable to revenue. A

I turn now to the Case stated by the Special Commissioners. In para. 1, after setting out particulars of the assessments, they say: B

“The question for our decision was whether Regent was entitled to deduct, in computing its profits as a dealer in oil, certain payments made to retailers in the circumstances hereinafter appearing, or whether such payments were (as the Crown contended) of a capital nature the deduction of which is prohibited by s. 137(f) of the Income Tax Act 1952.”

Then follows the admission by the Crown that the payments “were made wholly and exclusively for the purpose of Regent's trade”. In para. 2 they set out the earlier history of the matter and the decision of Danckwerts J. in the 1956 case<sup>(1)</sup>. Para. 3: C

“As the years went by the ‘exclusivity war’ intensified, and Regent was compelled to make payments to retailers in a form increasingly favourable to them in order to retain its stations, since its rivals made tempting offers to retailers whose contracts with Regent were about to expire in order to obtain such stations for themselves.” D

Then they exhibit a statement showing Regent's percentage of the total sales of motor spirit in the United Kingdom, and they say:

“It will be seen that such percentage declined from 14 per cent. in 1955 to 12 per cent. in 1961.” E

Para. 4:

“The form of payments to retailers with which the present case is concerned is that arising from a transaction of lease and sublease. Retailers were no longer content with payments to them of sums year by year calculated on gallonage sold; they demanded to be paid lump sums in advance, although these lump sums were still calculated by reference to the gallonage which it was anticipated would be sold at the station concerned. Retailers were also anxious that any payment received by them should if possible take a non-taxable form.” F

Then they set out the general provisions of the agreement to which I have referred. In para. 5 they set out the transaction in relation to Green Ace Motors; in para. 6 the transaction in relation to Clapps; in para. 7 the transaction in relation to Mr. Murphy and Modern Motors Ltd.; and in para. 8 the transaction in relation to the Smyths. Then, in para. 9 they set out the particulars of the amounts paid to the respective customers. Para. 10: G

“The above transactions by way of lease and sublease were the only ones of their nature in respect of which payments were made in the relevant years; their scope and importance in relation to Regent's trade in oil at the time can be seen from the following particulars” H

Then follow particulars of the number of stations at which Regent oil was sold and the number of stations which were tied, which was approximately 90 per cent. of the total. Then they state that 12 only were tied by this method

<sup>(1)</sup> Bolam v. Regent Oil Co. Ltd. 37 T.C. 56.

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A of lease and sublease; and that in 1959 about the same number were tied by this method. Then, sub-para. (c):

“The officials of Regent preferred the old sales agreement to the lease and sublease agreements, despite the somewhat greater security which it was hoped would ensue from the latter. They regarded the lease and sublease procedure, which was forced on them by retailers, with some distaste because of its novel and highly artificial nature.”

B [His Lordship then read paras. 11 to 15 of the Stated Case (at pages 6–7 *ante*), and continued:]

C It will be observed that the Special Commissioners quoted the well-known passages in *Atherton v. British Insulated and Helsby Cables Ltd.*<sup>(1)</sup> and in *Van den Berghs Ltd. v. Clark*<sup>(2)</sup>. I am told that a considerable number of other authorities were cited before them. These included *Green v. Favourite Cinemas Ltd.* (1930) 15 T.C. 390 (premium on lease); *United Steel Companies Ltd. v. Cullington* (1939) 23 T.C. 71 (consideration for closing down rival steel works); *Eastmans Ltd. v. Shaw* (1928) 14 T.C. 218 (expenditure on fixtures in connection with closing down and opening shops in a multiple chain); *Southwell v. Savill Bros. Ltd.*<sup>(3)</sup> 4 T.C. 430 (expense of unsuccessful applications by a brewer for new licences); *Knight v. Calder Grove Estates* (1954) 35 T.C. 447 (acquisition and sale of land for the purpose of opencast mining); and *H. J. Rorke Ltd. v. Commissioners of Inland Revenue*<sup>(4)</sup> 39 T.C. 194 (acquisition of rights over land for the purpose of opencast mining).

D The last two cases reaffirm the principle that, where a trader acquires an asset, in particular an interest in land, not itself for use as circulating capital but in order that by its use he may obtain circulating capital, the asset represents a capital asset and the expenditure in acquiring it represents a capital expenditure: see *per* Upjohn J. in *Knight v. Calder Grove Estates*, at page 453, where he said:

F “The case seems to me a perfectly plain one. The parties, being minded to get and win coal from this particular area by open-cast methods, purchased the land. They could have done it by some other means, but that is the means they chose—that of purchasing the land. That adventure in the nature of things is not likely to continue for more than two or three years, and they prudently arranged for the sale of this land when the adventure in relation to it comes to an end. No one suggests that the purchase of this land is circulating capital or stock-in-trade or anything of that sort. It is a purchase of land for the adventure, and so, on ordinary principles, the transaction must be regarded as a capital expenditure, just as when you buy land and put a factory on it, or buy land and sink a shaft. In my judgment, the fact that the adventure is not likely to continue for many years is quite irrelevant”;

G and *per* Cross J. in the *Rorke* case, at page 207, where he said:

H “Mr. Borneman sought to distinguish that part of the judgment”—that is, the passage which I have just read—

“on the ground that there was a purchase (albeit coupled with an obligation to repurchase when the operation was concluded), whereas here there is not a purchase but a lease for a short period with these lump sum payments

<sup>(1)</sup> 10 T.C. 155; [1926] A.C. 205.      <sup>(2)</sup> 19 T.C. 390; [1935] A.C. 431.

<sup>(3)</sup> [1901] 2 K.B. 349.      <sup>(4)</sup> [1960] 1 W.L.R. 1132.

(Pennycuick J.)

made on the signing of the lease. I cannot see that there is any distinction on this aspect of the matter between a purchase and a lease. If there had been only one transaction here, if this Company had simply entered into one lease for the purpose of open-cast mining, and had made these initial payments to get the lease, the fact that the whole operation was only to last a few months would, I think, have made no difference. The point would have been covered by Upjohn, J.'s judgment with which I entirely agree. That leaves the question of recurrence which Upjohn, J., left open. Mr. Borneman has of course in his favour the finding of fact that the payments were made a normal and recurrent incident in the trade or business of open-cast coal mining; and he says truly that the Crown has not been able to point to any case in which in face of a finding that the payments were a normal and recurrent incident in the trade or business in question, it has yet been held that they were capital payments. Logically, however, I cannot see that the recurrence of the payments makes any difference. If once you accept—as I must—the distinction between buying circulating capital and acquiring rights which enable you to get circulating capital, it seems to me that these payments are marked as being of a capital nature, and, if once you find that, the fact that the trader is conducting many transactions of a similar kind cannot really make any difference. In arriving at that conclusion, I get some help from the case of *Eastmans, Ltd. v. Shaw*, 14 T.C. 218. The facts were very different, but what Rowlatt, J., said on page 224 does, I think, tend to support the view that I have taken. Again, if the mere recurrence of similar operations made a difference, a very large concern could apparently be in a better position than a small one to argue that expenditure of the sort in question was revenue expenditure.”

The two cases which I have cited are striking instances of the strict application of the principle, notwithstanding the transitory and recurring nature of the acquisition. The same principle is, I think, clearly applicable no less where a trader acquires an asset in order by its use to dispose of his circulating capital than where he acquires the asset in order by its use to obtain his circulating capital.

In the form of transaction now under consideration, the premium paid by Regent represents the price paid by Regent for the leasehold interest under the head lease coupled with the tenant's covenants under the sublease. The interest under the head lease is of no value by itself, apart from the contingency of a forfeiture, but it is of great importance as the interest to which the tenant's covenants under the sublease are annexed. The interests under the head lease and the tenant's covenants under the sublease together represent an interest in land of substantial value, i.e., the right to insist that throughout the term the land shall be used as a station by the tenant bound to sell exclusively Regent's products. I see no ground upon which it could be maintained that the premium is referable to anything other than the acquisition of this interest. The contrary view involves a complete departure from the terms of the written instruments.

Mr. Monroe contends that, once it is accepted that the premium is the price of an interest of this character, it falls squarely within the principles as to capital expenditure laid down in the *British Insulated and Helsby Cables* case<sup>(1)</sup> as applied in the two opencast mining cases. In my judgment, this

(1) 10 T.C. 155.

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- A contention is well founded. The expenditure is made once and for all with a view to bringing into existence an asset, an advantage for the enduring benefit of the trade. Again, it is a right over land acquired in order, by its use, to dispose of Regent's circulating capital, i.e., its oil. It may be worth while to observe that the interest is from its nature perfectly capable of realisation, though no doubt in a limited market.
- B Mr. Borneman, for Regent, contends that the premium is not in truth paid for an interest in land, and that the interest acquired is in any event so small in relation to Regent's undertaking that it cannot realistically be treated as part of Regent's capital structure. For the reasons which I have given, it seems to me that the interest acquired by payment of the premium is in truth an interest in land and of a capital nature. Once this is accepted,
- C I do not think its nature can be altered by its relative insignificance. Most undertakings, however great, must, I imagine, possess a number of small capital assets, whether these are employed in the main activities of the undertaking or in some collateral activities. For example, a large manufacturing concern which normally sells to retailers may acquire an isolated shop. Whether an asset is of a capital nature must, it seems to me, depend upon its
- D character and functions rather than upon its size, whether intrinsically or in relation to the undertaking as a whole. On this point, I respectfully agree with the observations made by Cross J. in the case which I have just cited<sup>(1)</sup>. So here I do not think these interests, if of a capital nature, lose their character merely by reason of the fact that they are small in relation to Regent's whole undertaking. I should add that sums of the size now under consideration cannot on any view be dismissed as trifling. Nor can an interest which is
- E limited for 10 or 20 years be dismissed as *de minimis*.

Mr. Borneman points out that, in general, an outgoing incurred in order to preserve existing assets is in the nature of revenue. He refers to *Southern v. Borax Consolidated Ltd.*<sup>(2)</sup> 23 T.C. 597. But this rule cannot, it seems to me, apply where the volume of trade carried out with existing capital assets is

F shrinking and the trader, in order to keep up the volume of his trade, acquires new capital assets. Multiple shops offer an obvious example. In such a case, the expenditure on new assets seems to me to fall squarely within the express prohibition under s. 137(f).

Mr. Borneman says that the facts in this case are in essence the same as those in the 1956 case<sup>(3)</sup>, and that to treat the premiums as capital involves a departure from Danckwerts J.'s decision in that case. That is the last thing

G I am intending to do. It seems to me that the 1956 decision was made upon entirely different facts. There, the agreement under the solus plan brought into existence no interest or right beyond the personal obligation of the customer, and it was clearly proper to treat the payments under it as current trade expenditure in the nature of a rebate. Here, the payment was made in

H order to acquire a substantial interest in land. I observe the evidence given by the auditors and financial advisers, but it is not suggested that the form of Regent's accounts, although no doubt of weight, is in any way conclusive.

I turn finally to the conclusion as given by the Commissioners. They say, correctly, that the transactions of lease and underlease are firmly linked

<sup>(1)</sup> *H. J. Rorke Ltd. v. Commissioners of Inland Revenue* 39 T.C. 194.

<sup>(2)</sup> [1941] 1 K.B. 111.

<sup>(3)</sup> *Bolam v. Regent Oil Co. Ltd.* 37 T.C. 56.



(Pennyquick J.)

together, and resulted in the acquisition of a valuable right. They appear, however, to treat the interest in land as of negligible value and the right as being of a purely personal nature. Then they set out the various considerations which Mr. Borneman has advanced in his argument before me and conclude that it is a question of degree and that, having regard to all the circumstances, the payments in question are properly to be treated as of a revenue and not of a capital nature. I must naturally pay great attention to the view of the Commissioners on this point, and if I considered that the facts reasonably led to this conclusion I would uphold it. But it seems to me that, once the transaction here is analysed, the contrary conclusion is unavoidable. I must therefore allow this appeal. A B

I have also before me an appeal by way of Case Stated on assessments to profits tax upon Regent. These assessments are based on the same considerations as those for income tax, and the decision upon the income tax appeal necessarily governs that upon the profits tax appeal. I must accordingly allow that appeal also. C

**Monroe Q.C.**—Would your Lordship say that both appeals are allowed with costs?

**Borneman Q.C.**—I cannot resist that, my Lord. D

**Pennyquick J.**—I suppose so.

**Monroe Q.C.**—I think the appropriate Order, my Lord, is that the cases should be remitted to the Special Commissioners to adjust the assessments on the basis that the sums in dispute were capital payments. This may need to be put in more elaborate language, but perhaps that can be dealt with later.

**Pennyquick J.**—That would be right, Mr. Borneman? E

**Borneman Q.C.**—Indeed, my Lord, certainly.

**Pennyquick J.**—Very well.

**Monroe Q.C.**—I am much obliged, my Lord.

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The Company having appealed against the above decision, the cases came before the Court of Appeal (Lord Denning M.R. and Danckwerts and Diplock L.J.J.) on 4th and 5th June 1964. On 8th June 1964, judgment was given unanimously in favour of the Crown, with costs. F

*Roy Borneman Q.C. and Stewart T. Bates for the Company.*

*H. H. Monroe Q.C. and J. Raymond Phillips for the Crown.*

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**Lord Denning M.R.**—The facts appear from the Case Stated in this case and in the previous case of *Bolam v. Regent Oil Co. Ltd.* (1956) 37 T.C. 56, and I will only state sufficient to show the problem. There are three large suppliers of petrol in this country—Shell, Esso and Regent. Since the War there has been intense competition between them. Each of these three great companies has sought to get the owners of garages or filling stations to sell its brand of petrol only, and not to sell the brands of others. Each seeks to get the retailer to sell its brand of petrol exclusively. The competition is so intense that they call it an “exclusivity war”. The retailers have not been slow to take advantage of this war between the giants. They have bid the one against the G H



(Lord Denning M.R.)

A other. They ask each of the big companies: "What will you pay me if I tie myself to your products?" In the early stages the inducement held out by each company was a simple rebate. The company would offer the retailer a rebate of  $\frac{1}{4}d.$  or thereabouts on every gallon of petrol if he would promise to sell its brand to the exclusion of all others. The retailer would tie himself to the company offering the most rebate. Competition forced the rebates up. The next stage was

B that, instead of a rebate, the company paid a sum in advance to the retailer each year according to the estimated gallonage for the coming year. So the retailer received cash in hand at the beginning of the year, and then at the end of the year the figure was adjusted up or down according to the gallonage actually supplied. The retailer would tie himself to the company offering the best advance payment. The third stage was that, instead of an advance for one year, the

C company paid a lump sum in advance for five or six years ahead; and this was adjusted up or down afterwards according to the gallonage sold. That was the stage reached in *Bolam's* case<sup>(1)</sup>, where Danckwerts J. held that these advance payments made by a company were payments of a revenue nature. They were not capital expenditure. They could be deducted by the company in calculating its profits for tax purposes.

D We have now reached a further stage. Some of the retailers have taken even greater advantage of their bargaining position. They have extracted from the oil companies a sum in advance which is not to be returned in any circumstances, and, furthermore, in such a form that the retailers hope it will not be taxable in their hands. This form is known as "lease-sublease".

E I will describe it by reference to one of the cases. *First, the lease.* Green Ace Motors owned a garage and filling station in the Norwich Road at Ipswich. On 11th June 1956 the Regent Oil Co. Ltd. paid Green Ace Motors the sum of £5,000 which was described as "paid by way of premium". In return, Green Ace Motors demised to the Oil Company the garage and filling station for ten years from 13th May 1955, at a rent of £1 a year. The £5,000 was calculated in this way. It was estimated that the Green Ace company would, during the ten

F years, sell 1,200,000 gallons of petrol, and that the rebate on that gallonage would be at about *1d.* a gallon. That comes to £5,000 over the ten years. *Secondly, the sublease.* On the same day, 11th June 1956, the Oil Company sublet the property back again to Green Ace Motors. It sub-demised it for ten years less three days from 13th May 1955, at a rent of £1 a year. This sublease contained a specific covenant which tied Green Ace Motors to the Oil Company.

G It covenanted that during the term of the sublease it would buy all its requirements of motor fuels from the Oil Company and it would not sell any other fuel except that supplied by the Oil Company. It covenanted also to keep the premises open for the supply of fuel and not discontinue business or reduce the number of pumps. It could only assign the premises if it got a responsible person who would covenant to observe the tie. *Thirdly, additional payment.* On the

H same day, 11th June 1956, the Oil Company agreed that if during the ten years the Green Ace Motors company bought from it more than 1,200,000 gallons, it would pay or allow by way of rebate a penny a gallon on every gallon over 1,200,000. In other words, if the Green Ace company sold *more* than the estimated gallonage, it was to receive extra payment. But there was no provision for any adjustment if it sold *less* than the estimated gallonage. There was no

I provision for a repayment of any part of the £5,000. The Oil Company made similar agreements with the other owners of garages, but usually for longer

<sup>(1)</sup> 37 T.C. 56.

**(Lord Denning M.R.)**

terms of years and bigger payments. In some cases the sum paid was not described as a "premium" but just as a "sum".

The question is whether the £5,000 and similar sums which the Oil Company thus paid were sums employed by the Oil Company as *capital* in its trading; for if they were, the Oil Company was not entitled to deduct them in computing its profits: see s. 137(f) of the Income Tax Act 1952. But if they were of a *revenue* nature, of course, they could be deducted. The Special Commissioners held that the payments were properly to be deducted as of a revenue and not of a capital nature. Pennycuik J. held that the Commissioners could not reasonably come to that conclusion. He held that they were payments of a capital nature.

We were referred to several authorities on this subject, particularly the well-known words of Viscount Cave L.C. in *Atherton v. British Insulated and Helsby Cables Ltd.*<sup>(1)</sup> [1926] A.C. 205 and of Lord Macmillan in *Vanden Berghs Ltd. v. Clark*<sup>(2)</sup> [1935] A.C. 431, and the recent application of those principles in the opencast mining cases of *Knight v. Calder Grove Estates* (1954) 35 T.C. 447 and *H. J. Rorke Ltd. v. Commissioners of Inland Revenue*<sup>(3)</sup> [1960] 1 W.L.R. 1132. If you look at the transaction according to its legal form, the payment of the lump sum was to my mind clearly expenditure of a *capital* nature. It was paid by the Oil Company so as to acquire a lease for a term of years at a nominal rent. Whether described by the parties as a "premium" or as a "sum" it was nothing more nor less than a premium paid for a lease. If the Company had paid an annual rent for the term of years, the payments of rent, of course, would be of a revenue nature, but a premium paid at the beginning is clearly capital expenditure. It is a sum paid once for all so as to acquire a permanent asset. If this Company had put this permanent asset to profitable use by subletting it at a rack rent, the premium would clearly be capital used to produce revenue. So also when it puts the asset to profitable use by subletting it to a retailer in return for a tie. Even if you look at the transaction in a business sense you get the same result. The payment was made so as to acquire an exclusive output for the Company's oil for a term of years. This was an asset of a permanent nature which would bring in revenue throughout the term. Suppose the Company were to say to the owner of the piece of land: "We will pay you £5,000 if you will give us the exclusive right to sell petrol at this point for five years"—or ten years or 21 years, as the case may be—and was itself to sell direct to the public at that point, such a payment would clearly be a capital payment. I see no difference between that case and the present. True it is that the Company does not sell direct to the public but only sells through retailers. But the effect is the same. The Company says to the retailer, "We will pay you £5,000 if you will sell our products exclusively at this point for five years", or ten or 21 as the case may be. The Company makes a payment once and for all. In return it gets an advantage which is of enduring benefit to the Company. It brings in revenue to the Company week after week, and month after month, from the petrol it supplies to the retailer. I have no doubt this advantage is a capital asset and the payment for it is capital expenditure.

The burden of Mr. Borneman's argument before us was this. He said that these lump sum payments were really only rebates. They were allowed in advance here just as they were in *Bolam's* case<sup>(4)</sup>; and that these companies were merely the vehicle by which the allowance was made. I cannot accept this view at all.

<sup>(1)</sup> 10 T.C. 155.<sup>(2)</sup> 19 T.C. 390.<sup>(3)</sup> 39 T.C. 194.<sup>(4)</sup> 37 T.C. 56.

(Lord Denning M.R.)

A These lump sums were not rebates. True it is they were calculated on the estimated gallonage, but the measure of a thing is not to be confused with the thing itself. The yardstick is different from the cloth which it measures. We must look at these lump sums as they really were, payments for a permanent asset in the shape of an exclusive output of the Company's product, and as such they were capital payments.

B I would like to pay tribute to the care and consideration which the Commissioners gave to this case, but after reflection I have come to the conclusion that their decision was one to which they could not reasonably come. I think these payments were of a capital nature. I agree with Pennycuick J., and I would dismiss the appeal.

C **Danckwerts L.J.**—In *Bolam v. Regent Oil Co. Ltd.* 37 T.C. 56, sums paid by the Company to retailers of petrol by reference to "rebates" of so much per gallon of petrol sold were held not to be capital payments but deductible payments out of revenue for income tax purposes, albeit in some cases considerable sums were paid by the Company to retailers in advance of actual sales. The correctness of that decision is not contested by the Crown.

D The present case is concerned with some transactions (of a type of which it is said that there are only twelve examples) in which a different arrangement has been adopted. I am afraid that the Company has been pushed by the cupidity of the retailers, given strength by the competition of the oil companies, into a position which is disadvantageous to the Company, because the payments have become capital payments, and cannot be deducted from profits for purposes of income tax.

E The transactions are carried out by means of a lease at a nominal rent by the Company of the retailers' garages, with the further consideration of a lump sum payment by the Company, followed by a sublease at a nominal rent to the retailer, who enters into covenants which include a covenant restricting the retailer's sales of petrol to the products of the Company. In two cases the lump sum is described as a "premium" but in the other cases it is simply referred to as a sum of money.

F It has been argued on behalf of the Company that, as the lump sum has been calculated by reference to the rebate of  $1\frac{1}{2}d.$  per gallon on the estimated amount of petrol likely to be sold by the retailer during the period of the transaction, these transactions are essentially of the same character as those considered by the Court in *Bolam v. Regent Oil Co. Ltd.*, and the device of a lease and sublease is merely a vehicle for carrying out the same purpose of providing the retailers with their rebates and giving the Company security for the retailer's obligations. I am afraid that these arguments, in my opinion, cannot succeed. The real purpose of the transactions is, of course, to secure a tie, in the sense that the retailer and his petrol station are restricted to sale of the Company's products. This is an asset of commercial value in the fierce competition between the rival oil companies. In my opinion it is impossible to ignore the form which the transactions have taken. Very often the conveyancing forms adopted do decide the result of the operation which is carried out, not only for legal purposes, but also for the substance. It may well be that a form could have been devised by a skilful draftsman in which the purpose could have been achieved while preserving the payments as revenue and not capital payments.

I In the present case I am satisfied that the payments have been made capital

**(Danckwerts L.J.)**

payments, and one can see that the retailers may well have reasons for desiring that the payments to them should be capital payments.

In my opinion, therefore, the conclusion reached by the learned Judge was correct, and the appeal should be dismissed.

**Diplock L.J.**—I, too, agree. Counsel for the Company has attacked the judgment of Pennycuik J. on the grounds that he was mesmerised by the fact that this transaction involved the acquisition by the taxpayer of an interest in land. It is urged that we should look at it, not with the clouded gaze of a conveyancer, but with the penetrating observation of a business man; we should look not to the form, but to the substance. But this is a case in which the substance follows from the form. The purpose of acquiring the interest in land, the head lease, was that there might be attached to it, by means of the sublease to the dealer, covenants by the dealer under which he would be compelled for the duration of the lease (which varied in the cases under consideration from five to twenty years) to buy his petrol exclusively from the taxpayer, the Oil Company. Not only was he obliged under those covenants to buy all his petrol from the Oil Company, but he was compelled to continue to carry on the business during the duration of the lease, and not to reduce the number of his pumps. Furthermore, the covenants were so designed that, if he himself ceased to carry on the business or if he sought to assign the business, the premises on which the business was carried on would still be tied and continue to be used as an outlet, and an exclusive outlet, for the Oil Company's oil. This was what the Oil Company acquired by the premium paid for the head lease. It seems to me plainly that it was a capital sum expended to secure an advantage of enduring benefit during the period of the head lease.

Pennycuik J. held that the Commissioners could not, on those facts, reasonably come to the conclusion that the payments were of a revenue nature. I should hesitate always to say that the Commissioners had come to a conclusion which no reasonable person could come to, but it seems to me that in this case the Commissioners reached their decision as a result of misdirecting themselves on a matter of law. In the Case Stated they refer to the well-known *dictum* of Viscount Cave L.C. in *Atherton v. British Insulated and Helsby Cables Ltd.*<sup>(1)</sup>, where he refers to assets or advantages for the enduring benefit of the taxpayer's trade. I think it is fairly plain from what follows in the course of the Case Stated that the Commissioners interpreted "enduring" benefit not in relation to time but in relation to size. They also refer to Lord Macmillan's observations in *Van den Berghs Ltd. v. Clark*<sup>(2)</sup>, and put the question which they considered they had to determine thus:

"... were the several transactions with retailers 'ordinary commercial contracts made in the course of carrying on [Regent's] trade . . . contracts for the disposal of [its] products' . . . or did such contracts on the contrary, 'relate to the whole structure of [Regent's] profit-making apparatus'?"

That, it is true, was the antithesis on the facts of *Van den Berghs'* case, but on the facts of this case it is a false antithesis, for it matters not whether the contract relates to the whole structure of Regent's profit-making apparatus. What matters is whether or not they were moneys which were expended to obtain an enduring benefit for the trade, even though the benefit related only to a small part of the trade.

<sup>(1)</sup> 10 T.C. 155, at pp. 192-3.

<sup>(2)</sup> 19 T.C. 390, at p. 431.

(Diplock L.J.)

A The reason I think that the Commissioners have misunderstood or misapplied those citations is because in the next sentence they go on to say this:

“In our opinion these questions”—that is to say, the questions they had extracted from *Atherton's*<sup>(1)</sup> and *Van den Berghs*<sup>(2)</sup> cases—“had to be answered having regard to the whole nature, extent and scope of Regent's trade, including the fact that the payments in question were not expected to secure an increase in Regent's share of the oil trade but only to maintain it.”

B With the greatest respect, that was an irrelevant consideration. If a trader acquires a capital asset in order to carry on trade, to produce his stock-in-trade or to enable him to sell it, it matters not whether he does it in the hopes of extending his business or of maintaining that business. To instal a new machine is to acquire a capital asset, whether it is to replace an obsolete machine and retain trade against competition or whether it is to extend the trade.

The next point to which they refer in their Case is this. They go on to say:

“What might be an enduring advantage in the case of a company with a small and limited turnover would probably be an insignificant matter in the case of a company with a worldwide or nation-wide trade.”

D That, again, with great respect, seems to me to be an irrelevant consideration; whether it is a capital asset or not depends not upon its size in relation to the size of the total business done by the company. The Commissioners then go on to say:

“It was therefore a question of degree . . .”

E I think they are here misdirecting themselves. The question was not a question of degree. It was a question of principle: what was the nature of the asset acquired? This did not depend upon the size nor upon whether it was acquired in order to increase or maintain trade. I agree that the payments made were payments of a capital nature and the appeal should be dismissed.

**Monroe Q.C.**—My Lord, I am instructed to ask for costs.

F **Lord Denning M.R.**—That must be right. The appeal is dismissed with costs.

**Borneman Q.C.**—May I take this opportunity of making an application to your Lordships? It has, of course, not yet been possible for the Company really to consider your Lordships' judgments, but if they subsequently find they wish to, may they have your Lordships' permission to take this matter to the House of Lords?

G **Lord Denning M.R.**—No, Mr. Borneman, we shall not give leave. There are two appeals and the same Order is made in both.

H The Company having obtained leave from the Appeal Committee to appeal against the above decision, the cases came before the House of Lords (Lords Reid, Morris of Borth-y-Gest, Pearce, Upjohn and Wilberforce) on 15th, 16th, 17th, 21st, 22nd and 23rd June 1965, when judgment was reserved. On 27th July 1965, judgment was given unanimously in favour of the Crown, with costs.

(<sup>1</sup>) 10 T.C. 155.      (<sup>2</sup>) 19 T.C. 390.

(<sup>1</sup>) *Roy Borneman Q.C.* and *Stewart T. Bates* for the Company. The question at issue is whether these payments are of an income or of a capital nature. It is the Company's contention that they constitute revenue expenditure for the following reasons: (1) The issue is one of law. (2) The proper approach is to take all the relevant facts into consideration. There is no final test, whether inclusive or exclusive, that gives the answer. Dicta in the cases are merely indications or examples; they are "descriptive rather than definitive": *per* Viscount Radcliffe in *Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.*(<sup>2</sup>). Viscount Cave L.C. was not using his famous phrase, "for the enduring benefit of a trade," to be found in *British Insulated and Helsby Cables Ltd. v. Atherton*(<sup>3</sup>), in a way that affects this case. (3) Form itself does not inhibit any court from deciding whether in all the circumstances of the case expenditure is made on revenue or capital account. It is to be remembered that this is a commercial case and therefore is not to be approached in the way a conveyancer might do. (4) On the facts considered in their context these lease and sublease agreements are nothing but a continuation of acknowledged and accepted trading methods, and therefore the payments are to be considered as ordinary marketing costs incidental to and part of the day-to-day business of selling. The lease and sublease are nothing more than a vehicle for the day-to-day transaction of paying rebate which the dealer would otherwise have had to pay. It cannot be said that the Appellant was at any time interested in obtaining an interest in land. To adopt language to be found in earlier cases, these payments were "an outlay in a business": *per* Lord Sumner in *John Smith & Son v. Moore*(<sup>4</sup>); the agreements were "ordinary commercial contracts made in the course of carrying on their trade; . . . contracts for the disposal of their products": *per* Lord Macmillan in *Van den Berghs Ltd. v. Clark*(<sup>5</sup>). (5) It would be shutting one's eyes to commercial realities to say that Regent did obtain any real interest in land at all; for the relevant purpose these lease and sublease agreements are artificial. (6) These lease and sublease agreements must be considered in the context of the whole trade—they are six out of some 5,000 agreements, the balance of the 5,000 being the old type of agreement payments which are deductible under *Bolam v. Regent Oil Co. Ltd.*(<sup>6</sup>). (7) In the context of the whole trade it is not decisive either way whether the tie is for six months, three years, five years, seven years, 10 years or 20 years. In every case the sum payable was calculated by reference to the time it was expected it would take to work off the rebate in respect of the estimated gallonage likely to be sold. In each and every case all that is being done is to maintain the sales and turnover to a greater or lesser degree. (8) The tie is not a capital asset in the sense predicated by Viscount Cave. It is not the kind of enduring asset he had in mind. These ties give no monopoly in the area concerned. (9) The law and ordinary principles of commercial accounting require that expenditure on the acquisition of the whole or relevant part of the profit-making structure is chargeable to capital, but the law and ordinary principles of commercial accounting require that expenditure incurred in the use of the profit-making structure is chargeable to revenue.

For tax purposes it is necessary to inquire whether the label used in describing a transaction is a true label, namely, here, whether the "premium" mentioned in two of these leases was in fact a premium: see *per* Lord Denning in *Ralli*

(<sup>1</sup>) Argument reported by J. A. Griffiths, Esq., Barrister-at-law.

(<sup>2</sup>) [1964] A.C. 948, 959.

(<sup>3</sup>) 10 T.C. 155, 192; [1926] A.C. 205.

(<sup>4</sup>) 12 T.C. 266, 297; [1921] 2 A.C. 13.

(<sup>5</sup>) 19 T.C. 390, 431; [1935] A.C. 431.

(<sup>6</sup>) (1956) 37 T.C. 56.



A *Estates Ltd. v. Income Tax Commissioner*<sup>(1)</sup> and per Rowlatt J. in *Jones v. Commissioners of Inland Revenue*<sup>(2)</sup>.

Reliance is placed on the observation of Lord Dunedin in *Vallambrosa Rubber Co. Ltd. v. Farmer*<sup>(3)</sup> that:

B “it is not a bad criterion of what is capital expenditure—as against what is income expenditure—to say that capital expenditure is a thing that is going to be spent once and for all, and income expenditure is a thing that is going to recur every year.”

C Viscount Cave L.C.’s dictum in *British Insulated and Helsby Cables Ltd. v. Atherton*<sup>(4)</sup> is not a formula and was never intended to be used as such. If this dictum is to be looked upon as a guide applicable to the present case, then, until it can be shown that the tie is so permanent that it forms part of the fixed capital structure of the company, it cannot be said that it “endures” in the sense in which that expression is used by Lord Cave.

In *Sun Newspapers Ltd. v. Federal Commissioner of Taxation*<sup>(5)</sup>, Dixon J. said:

D “The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between the business entity, structure, or organisation set up or established for the earning of profit and the process by which such an organisation operates to obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss.”

E Applying that test here, the marketing system under which the oil companies now operate is a system by which the companies obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss.

Reliance is placed on observations made in the *Nchanga* case<sup>(6)</sup>:

F “Preservation expenditure, which in one form appears as maintenance, does not suggest itself to their Lordships as being in itself a satisfactory category of expenditure for capital purposes . . . a court’s primary duty is to inquire how far a description that was both relevant and significant in one set of circumstances is either significant or relevant in those which are presently before it. For example, while it is certainly important that in *Atherton’s* case expenditure that did secure an enduring benefit for a company’s business was spoken of as being for that reason a capital expenditure, it would be a misuse of that authority to suppose that it gives any warrant for the idea that securing a benefit for the business is prima facie capital expenditure, so long as the benefit is not so transitory as to have no endurance at all.”

G In *Commissioners of Inland Revenue v. Adam*<sup>(7)</sup>, it was stated that it is relevant to consider the way that the taxpayer makes up his accounts. It is submitted that Lord President Clyde would have held here that these payments were part of the company’s “working expenses”. *Henriksen v. Grafton Hotel Ltd.*<sup>(8)</sup> shows that all the facts have to be taken into consideration. There is a

(1) [1961] 1 W.L.R. 329, 334, P.C.

(2) 7 T.C. 310, 314; [1920] 1 K.B. 711.

(3) 5 T.C. 529, 536; 1910 S.C. 519.

(4) 10 T.C. 155, 192.

(5) (1938) 61 C.L.R. 337, 359 (Australia).

(6) [1964] A.C. 948, 958, 959.

(7) 14 T.C. 34, 40; 1928 S.C. 738.

(8) 24 T.C. 453; [1942] 2 K.B. 184.



sharp dividing line between profit-making structure and trading expenses. A  
 [Reference was also made to *Anglo-Persian Oil Co. Ltd. v. Dale*<sup>(1)</sup>; *Mitchell v. B. W. Noble Ltd.*<sup>(2)</sup>; *Hallstroms Proprietary Ltd. v. Federal Commissioner of Taxation*<sup>(3)</sup>.]

Strong reliance is placed on *Rhodesia Railways Ltd. v. Bechuanaland Protectorate Income Tax Collector*<sup>(4)</sup>. Just as on the facts there, so here, this B  
 money, which was paid day in day out to dealers, "did not result in the creation of any new asset; it was incurred to maintain the appellants' existing 'business' in a state to earn revenue." Thus, advertising expenditure, although it leads to advantages which endure for several years, has always been accepted as revenue expenditure save in the case of an initial advertising campaign entered into in order to obtain a footing in a new trade.

*Bolam's* case<sup>(5)</sup> was rightly decided and the present case is a logical C  
 extension of it. The following are the relevant considerations: (1) In all the relevant circumstances the payments constituted day-to-day marketing costs. The payments are made under ordinary commercial contracts in the course of and for the purpose of the disposal of the products which the company is in business to sell, the disposal being an essential part of the trading operations the profits of which are subject to tax. (2) In all the relevant circumstances the payments D  
 are made in pursuance of the process by which the whole organisation of Regent operates to obtain regular returns by means of regular outlays, the difference between the returns and the outlays being the profit on which the Company is subject to tax under Case I of Schedule D. (3) It is both the custom of the trade and the accepted pattern in the trade to make the payments as one of the normal incidents and concomitants of selling or disposing of petrol by E  
 companies concerned in selling petrol in the course of their trade. (4) The payments are incidental to the day-to-day business of selling petrol. (5) The payments constitute rebates or discounts on the price normally charged for petrol supplied to retailers or provide for a reduction in the price which would normally be paid for the petrol supplied, and in this connection it has been established in this case that the payments are arithmetically tied to gallonage F  
 supplied. (6) The payments are made pursuant to agreements made day by day in accordance with the custom and accepted pattern of the trade and are made in pursuance of agreements which fall in at regular and frequent intervals. The day-to-day recurrence is a factor in determining their quality. (7) The payments do not result in the acquisition of a capital asset of any substance. They do not result in or confer any monopoly as regards a particular geographical G  
 area and they are to be looked at in this particular context as payments made pursuant to the accepted method whereby orders for petrol and sales of petrol at one particular point of sale are obtained. (8) The purpose of the advantage obtained and the purpose of making the payments was to retain or recover sales and, on the businessman's approach, to make sales. Also, on the lawyer's approach, the payments were made to defend an established position and an H  
 established goodwill, which in the context of this case means a share of the market. (9) The auditors take the view that the payments should be charged to revenue, that is, in accord with the ordinary principles of commercial accounting they should be charged to revenue rather than to capital: see para. 15 of the Case stated in *Bolam's* case<sup>(6)</sup>, the Case stated in the present case and para. 14

<sup>(1)</sup> 16 T.C. 253; [1932] 1 K.B. 124.

<sup>(2)</sup> 11 T.C. 372; [1927] 1 K.B. 719.

<sup>(3)</sup> (1946) 72 C.L.R. 634 (Australia).

<sup>(4)</sup> [1933] A.C. 368, 374.

<sup>(5)</sup> 37 T.C. 56.

<sup>(6)</sup> 37 T.C. 56, 63.

A of Sch. 8 to the Companies Act 1948. (10) These ties are not part of the profit-making structure of the company.

As to the nature of a premium, see Halsbury's *Laws of England*, 3rd ed. (1958), vol. 23, p. 804, para. 1583: "Each case must be decided on its own facts and the substance of the transaction must be regarded, not the name given to the payment." The principle enunciated by Uthwatt J. in *Samuel v. Salmon & Gluckstein Ltd.*<sup>(1)</sup> is adopted. See also *Watney v. Musgrave*<sup>(2)</sup>; *Green v. Favourite Cinemas Ltd.*<sup>(3)</sup>. In the present case, a premium is part of the consideration for this commercial agreement—it is a sum of money made up of several annual payments.

C [Reference was also made to *Whimster & Co. v. Commissioners of Inland Revenue*<sup>(4)</sup>; *Evans v. Wheatley*<sup>(5)</sup>; *Commissioners of Inland Revenue v. Coia*<sup>(6)</sup>; *McLaren v. Needham*<sup>(7)</sup>; *Walter W. Saunders Ltd. v. Dixon*<sup>(8)</sup>; *Thompson v. Magnesium Elektron Ltd.*<sup>(9)</sup>.]

D *H. H. Monroe Q.C.* and *J. Raymond Phillips* for the Crown. The starting-point is the question *for what* was the sum in question paid? It is not *why* was it paid but *for what* was it paid? and it adds little in the present case to frame the question in the form for what was it *really* paid? because here there is little difference between form and substance. The answer to the question as above formulated is: for an interest in land, but it matters not for present purposes if it is expressed as: for the exclusive right to have Regent petrol sold at a particular site.

E The question then arises: in the context of the Appellant's business, is this transaction a capital or revenue matter? It is the Crown's contention that the cost of this right was essentially "the cost of creating, acquiring or enlarging the permanent (which does not mean perpetual) structure of which" sales of petrol would "be the produce or fruit": see *Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.*<sup>(10)</sup>

F If a premium is the price paid for an interest in land, then it is equivalent to a sum paid for the purchase of, for example, a lorry, which undoubtedly goes on capital account. As to the difference between (1) a premium and (2) rent, (1) a premium is a sum that represents the price of a right, a once-and-for-all lump-sum payment; (2) rent is not the price payable for the whole right, but is a "pay as you go" payment for the use of land. A sharp distinction is to be drawn between a premium, which is the price paid for an interest in land—the price of a lease—and the rent, which is a payment made under the lease. A premium includes everything that is not repayable if the tenant defaults under the terms of the lease.

H The bargain between the Company and a garage owner in the present case is not "if you sell x gallons of our petrol we will pay you £y", the *Bolam*<sup>(11)</sup> type of agreement, but is "if you will grant us the exclusive right for, for example, five years to sell our petrol at your garage we will give you £y, and we arrive at that sum of £y because we estimate that z is the number of gallons that you will sell." The difference is that in one case the Company is really paying for the number of gallons the dealer sells, whilst in the other there is a payment

(1) [1946] Ch. 8. 12.

(2) (1880) 1 T.C. 272; 5 Ex.D. 241. (3) (1930) 15 T.C. 390.

(4) 12 T.C. 813; 1926 S.C. 20.

(5) (1958) 38 T.C. 216.

(6) 38 T.C. 334; 1959 S.C. 89.

(7) (1959) 39 T.C. 37.

(8) (1962) 40 T.C. 329.

(9) (1943) 26 T.C. 1.

(10) [1964] A.C. 948, 960.

(11) 37 T.C. 56.

based on an estimate of the number of gallons likely to be sold. The way the money is paid indicates the nature of the rights acquired. These payments relate to the Company's capital structure and therefore they are of a capital nature. A

As to the Appellant's "vehicle" argument, the answer is that the vehicle used here was a capital asset. The fact that the Company regarded these exclusivity agreements as part of the Company's marketing expenses is to confuse the motive for payment with for what it was paid. The Company's method was to have a large number of capital assets. B

It is emphasised that, if the bargain is that the whole sum is to be paid in advance, then it goes on capital account, for it secures an enduring advantage. Recurrence of the payment is not a decisive factor, for it may be the repeated acquiring of capital assets or repeated expenditure on revenue account. In each case the question has to be asked: *for what* was the sum paid? Further, the duration of the asset or right is not a significant factor. There can be a payment in respect of a capital asset even though the asset or right is of extremely short duration provided it subsists for a longer term than the year in which it is acquired, that is, over the accounting period. C

The Crown concede that lease and sublease are tied up together. What the Appellant has paid for is a leasehold reversionary interest. This is a right in the nature of a permanent interest in land which has certain attributes, of which the relevant attributes here are the covenants contained in the sublease. This shows that the Company had a very valuable interest in land which might turn into an interest in possession should the garage proprietor go out of business. D

For tax purposes the Court is entitled to consider the surrounding circumstances and the events which led up to the execution of the relevant document. The object of these documents was not merely to secure rebate for the dealers but also to secure enduring benefits for the Company. E

The relevant considerations for resolving the problem whether a payment is capital or revenue expenditure are these: (a) the character of the asset acquired; (b) the use to which it is put; (c) how the payment is to be made: see *per* Dixon J. in *Sun Newspapers Ltd. v. Federal Commissioner of Taxation* (1). Irrelevant considerations are: (i) the recurrence of the payments, unless they are not only recurrent but also periodic; (ii) the relative size or importance of the right; (iii) the custom of the trade; (iv) measurement by reference to gallonage; (v) the view taken by the auditors; (vi) that the motive was to maintain or recover sales, for this is to confuse purpose with what the payment was actually for. F G

As to the cases dealing with the acquisition of short-term assets, in law the fact that an asset is of short duration does not prevent it from being a capital asset. In *MacTaggart v. Strump*(2) the premium paid for the five-year lease was capital expenditure in that it was an essential preliminary to carrying on the taxpayer's business. So here, the scheme for the tie of the garages is necessary for the carrying on of the Appellant's trade. *Charles Marsden & Sons Ltd. v. Commissioners of Inland Revenue*(3) establishes that it is insufficient to answer the legal question, capital or income, to state that the sum paid is a payment in advance but that it is necessary to ascertain the nature of the payment. In *Adam's case*(4) it is plain that the sum of £3,200 was a preliminary expense H

(1) 61 C.L.R. 337, 363.

(2) 10 T.C. 17; 1925 S.C. 599.

(3) (1919) 12 T.C. 217.

(4) 14 T.C. 34.

- A incurred in the course of running the business. *Eastmans Ltd. v. Shaw*<sup>(1)</sup> shows that it is necessary to look at the part played by the asset in the particular trade to ascertain whether the payment for the asset is a capital or revenue matter. Further, *Henriksen v. Grafton Hotel Ltd.*<sup>(2)</sup> is authority for the proposition that a payment which is made for an asset lasting only three years and which will thereupon have to be repeated to acquire a new asset for the same purpose is not a recurring payment and must be treated as a capital outlay. [Reference was made to *Associated Portland Cement Manufacturers Ltd. v. Commissioners of Inland Revenue*<sup>(3)</sup>; *Pyrah v. Annis & Co. Ltd.*<sup>(4)</sup>.]

- B The Crown do not dispute the proposition for which the *Ralli Estates* case<sup>(5)</sup> and *Jones' case*<sup>(6)</sup> were cited. In the *Vallambrosa* case<sup>(7)</sup> the expenses claimed belonged, because of their character, essentially to the trading account.
- C The *Sun Newspapers* case<sup>(8)</sup> is helpful because it brings out the differences so clearly. Any expenditure that goes on for more than a year is essentially of a capital nature. Alternatively, it is necessary to consider the nature of the structure. Here, the payments are adding to the structure and are not, as the Company contends, payments expended for operating the structure. To constitute capital expenditure it is not necessary for a payment to relate to the whole of the structure; it can be capital if it relates only to part thereof. The *Rhodesia Railways* case<sup>(9)</sup> is distinguishable. Repairs are *sui generis*, for their purpose is to keep the whole of the structure in a particular condition.

- D As to the receipt cases, *Evans v. Wheatley*<sup>(10)</sup> was rightly decided if *Bolam's* case<sup>(11)</sup> was rightly decided. But this line of cases is not of material assistance here. In any event, the way the recipient chooses to spend the money cannot be a deciding factor as is suggested in some of them.

- E *Roy Borneman Q.C.* in reply. It is to be observed that the Crown accept the decision in *Bolam's* case. The fact that there are a few ties lasting for up to 21 years is not significant in relation to the immense size of the activities of this company. Although this is a question of law it is to be noted that the Special Commissioners, who are the judges of fact, having taken into account all the relevant facts, did not consider that a 21-year tie is too long for a payment in respect thereof to qualify as a revenue expenditure.

- F It is said that an interest in land must be a capital asset and therefore that a payment in respect thereof must be a capital payment. But this begs the question unless the form above of the lease and sublease agreement concludes the matter. The House is invited to put aside mere formalism and to pay regard to the commercial realities of the transaction, which are that this arrangement was merely a vehicle to enable a dealer to obtain rebates. Basically the arrangements which underlie both *Bolam's* and the present case are that rebates or discounts are paid by reference to the gallonage bought by the dealer.

[Reference was also made to *Whimster & Co. v. Commissioners of Inland Revenue*<sup>(12)</sup>.]

(<sup>1</sup>) (1928) 14 T.C. 218.

(<sup>2</sup>) 24 T.C. 453.

(<sup>3</sup>) (1945) 27 T.C. 103.

(<sup>4</sup>) 37 T.C. 163; [1957] 1 W.L.R. 190.

(<sup>5</sup>) [1961] 1 W.L.R. 329.

(<sup>6</sup>) 7 T.C. 310.

(<sup>7</sup>) 5 T.C. 529.

(<sup>8</sup>) 61 C.L.R. 337.

(<sup>9</sup>) [1933] A.C. 368.

(<sup>10</sup>) 38 T.C. 216.

(<sup>11</sup>) 37 T.C. 56.

(<sup>12</sup>) 12 T.C. 813.

**Lord Reid**—My Lords, two consolidated appeals are before your Lordships. A  
 It is admitted by all parties that any decision in the first must necessarily govern the second, so I do not propose to say anything about the second appeal. The first arises out of assessments to income tax for the years 1957–58 and 1960–61. B  
 The Appellants import and refine oil, and sell petrol and other oil products to garages and service stations for resale to motorists. During those years they made arrangements of various kinds with those retailers under which they paid substantial lump sums to them. This case is only concerned with one such arrangement in the former year, under which £5,000 was paid, and with three in the latter year, under which a total of £195,699 was paid. The question to be decided is whether these payments can be taken into account so as to diminish the Appellants' profits for income tax purposes. The Special Commissioners held that they could, but their decision was reversed by Pennycuik J. and the Court of Appeal dismissed the Appellants' appeal. C

It is necessary not only to consider the circumstances in which these payments were made, but also to have regard to the manner in which the Appellants had been and were conducting their business. It appears that for some time past almost the whole of the petrol sold in this country has been the product of three oil companies, and the Appellants' share of the market has generally been in the neighbourhood of 13 or 14 per cent. During the last war petrol was not sold under brand names, but after 1945 the three companies began to prepare for resumption of selling under the well-known brand names. It had been the custom for most garages to have pumps from which they supplied the petrol of more than one of these companies. But in 1950 one of the other companies started what has been called the exclusivity war. The Appellants did not want to join in it, but they were forced to because within a few months a large proportion of garages had accepted a tie of some kind. D E

There was intense competition between the oil companies, each trying to induce each garage or service station to sell its own products exclusively. At first they were able to obtain such ties at comparatively small cost. But soon garage owners found themselves in a strong position, so that they were able as time went on to obtain better and better terms for accepting ties. At first the Appellants were able to obtain agreements of that character by offering a rebate of as little as  $\frac{1}{4}d.$  per gallon or offering to make small payments towards improvements of the service station, and the ties were then generally for a year or less. But soon garage owners were able to insist on lump sum payments in advance for longer ties—if one company would not pay another would. The Appellants attach importance to the fact that they always calculated the lump sum which they were prepared to offer by estimating the gallonage likely to be sold during the period of the tie and multiplying by their current rate of rebate. But that rate continued to increase and had soon passed 1d. per gallon. The earlier history is set out in the Case Stated in *Bolam v. Regent Oil Co. Ltd.* 37 T.C. 56, and by agreement the relevant parts of that Stated Case are incorporated in the Case Stated in the present case. By the time that *Bolam's* case was raised the ties then current varied in duration from a few months to five or six years. F G H

Having succeeded in obtaining rather large lump sums for granting ties, garage owners naturally wished to ensure if they could that the lump sums were received by them as capital receipts so as not to attract income tax, and someone appears to have devised the form of tie which appears in the four instances in the present case. The Appellants were unwilling to adopt it, but they had to yield because otherwise they would have lost these outlets for the sale of their petrol; some other oil company would have accepted the garage owner's demands, or at least so they feared. I

(Lord Reid)

A The essence of this new form of tie is that the garage owner grants to the oil company a lease of his premises (or at least of that part containing the petrol pumps and storage tanks) for the agreed period of the tie. The consideration for this lease is the agreed lump sum payment plus a nominal rent of £1 per annum. On the same day the oil company then grants to the garage owner a sublease of the same premises for the same period less three days, the consideration for the sublease being the same nominal rent of £1. But the sublease contains covenants or conditions whereby the garage owner is bound to buy the petrol which he needs for resale from that oil company and from no one else. The net result is that no money passes except the agreed lump sum, and the oil company gets its tie. But this machinery is not a sham. There is no difference from the old form of a tie by agreement so long as all goes well; but if the garage owner defaults this new form of tie gives the oil company a better way of enforcing its rights by bringing the sublease to an end and standing on its rights under the lease. I should add that in two of these four cases the lump sums are expressly stated to be premiums, while in the other two they are not, but I do not think that this makes any difference.

D Whether a particular outlay by a trader can be set against income or must be regarded as a capital outlay has proved to be a difficult question. It may be possible to reconcile all the decisions, but it is certainly not possible to reconcile all the reasons given for them. I think that much of the difficulty has arisen from taking too literally general statements made in earlier cases and seeking to apply them to a different kind of case which their authors almost certainly did not have in mind—in seeking to treat expressions of judicial opinion as if they were words in an Act of Parliament. And a further source of difficulty has been a tendency in some cases to treat some one criterion as paramount and to press it to its logical conclusion without proper regard to other factors in the case. The true view appears to me to be that stated by Lord Macmillan in *Van den Berghs Ltd. v. Clark*<sup>(1)</sup> [1935] A.C. 431, at page 438:

F “While each case is found to turn upon its own facts, and no infallible criterion emerges, nevertheless the decisions are useful as illustrations and as affording indications of the kind of considerations which may relevantly be borne in mind in approaching the problem.”

G One must, I think, always keep in mind the essential nature of the question. The Income Tax Act requires the balance of profits and gains to be found. So a profit and loss account must be prepared setting on one side income receipts and on the other expenses properly chargeable against them. In so far as the Act prohibits a particular kind of deduction it must receive effect. But beyond that no one has to my knowledge questioned the opinion of Lord President Clyde in *Whimster & Co. v. Commissioners of Inland Revenue* 1926 S.C. 20; 12 T.C. 813, where, after stating that profit is the difference between receipts and expenditure, he said<sup>(2)</sup>:

H “the account of profit and loss to be made up for the purpose of ascertaining that difference must be framed consistently with the ordinary principles of commercial accounting, so far as applicable.”

So it is not surprising that no one test or principle or rule of thumb is paramount. The question is ultimately a question of law for the Court, but it is a question which must be answered in light of all the circumstances which it is reasonable

<sup>(1)</sup> 19 T.C. 390, at pp. 428–9.      <sup>(2)</sup> 12 T.C., at p. 823.



**(Lord Reid)**

to take into account, and the weight which must be given to a particular circumstance in a particular case must depend rather on common sense than on a strict application of any single legal principle. A

The purpose of any commercial account must be to give as fair and accurate a picture as possible of the trader's financial position. But the provisions of the Act as they have been interpreted make that difficult where a wasting asset has been acquired. As explained in *Kauri Timber Co. Ltd. v. New Zealand Commissioner of Taxes* [1913] A.C. 771, it had long been settled that, if capital has been expended in acquiring or producing a wasting asset, it is not permissible to bring into the profit and loss account for tax purposes a part of that capital corresponding to the wasting or depreciation of the asset during the year; no part of the expenditure can be set against income in any year. These old cases were dealing with expenditure made to acquire or improve tangible assets and as regards a great many of them, such as machinery, plant, buildings and mines, the severity of this rule has been relaxed by statutory provision for annual and other allowances. But the rule still stands as regards matters not particularly dealt with by the Act. If a trader acquires a rapidly wasting asset not covered by these statutory provisions he would not generally strike his balance of profits and gains without taking account of the annual wasting or diminution of value of that asset. But if his expenditure in acquiring it has to be regarded as capital expenditure he cannot do that for income tax purposes. B C D

When one is dealing with tangible assets it is generally not very difficult to reach a decision. Things which the trader uses in his business to produce what he has to sell are part of his fixed capital and their cost is a capital outlay although their useful life may be short, as in *Hinton v. Maden & Ireland Ltd.*<sup>(1)</sup> [1959] 1 W.L.R. 875. Things which he turns over in the course of his trade are circulating capital and their cost is a revenue expense. The things in respect of which the Act permits allowances are fixed capital. Difficulties can arise when a capital asset is improved, e.g., in distinguishing between repairs, which are a revenue expense, and renovation, which is not; but I do not think that much assistance can be got in this case from cases dealing with tangible assets, and I need only mention two. In *Vallambrosa Rubber Co. Ltd. v. Farmer*<sup>(2)</sup> 1910 S.C. 519 the expense of maintaining a rubber plantation was allowed as a revenue expense although the trees would yield no rubber for some years to come. Lord President Dunedin said<sup>(3)</sup>: E

“in a rough way I think it is not a bad criterion of what is capital expenditure as against what is income expenditure to say that capital expenditure is a thing that is going to be spent once and for all, and income expenditure is a thing that is going to recur every year.” F G

And in *Ounsworth v. Vickers Ltd.*<sup>(4)</sup> [1915] 3 K.B. 267 Rowlatt J. held that the expense of making what was in effect a new means of access was capital expenditure. With regard to the passage in Lord Dunedin's opinion which I have just quoted, he said<sup>(5)</sup>: H

“I take it and indeed both sides agree that no stress is there laid upon the words ‘every year’: the real test is between expenditure which is made to meet a continuous demand as opposed to an expenditure which is made once for all.”

(<sup>1</sup>) 38 T.C. 391. (<sup>2</sup>) 5 T.C. 529. (<sup>3</sup>) *Ibid.*, at p. 536. (<sup>4</sup>) 6 T.C. 671.

(<sup>5</sup>) [1915] 3 K.B., at p. 273; 6 T.C., at p. 675.



(Lord Reid)

- A When one comes to intangible assets there is much more difficulty. To help the conduct of his business a trader obtains a right to do something on someone else's property or an obligation by someone to do or refrain from doing something, or makes a contract which affects the way in which he conducts his business. And the right or obligation or the effect of the contract may endure for a short or a long period of years. The question then arises whether the sum
- B which he has paid for that advantage is a capital or revenue expense. As long ago as 1914 it was settled in *Usher's Wiltshire Brewery Ltd. v. Bruce*<sup>(1)</sup> [1915] A.C. 433 that in determining profit a deduction

“is to be made or not to be made according as it is or is not, on the facts of the case, a proper debit item to be charged against incomings of the trade when computing the balance of profits of it”

- C (per Lord Sumner at page 468<sup>(2)</sup>).

- Where the wasting asset is a right to some benefit for a period of years and the consideration given for it is the payment of an annual sum during the continuance of the right there is generally no difficulty. Rent payable under a lease or under an agreement for the hire of a machine is treated as a proper debit against incomings, and the same must, I think, apply to an annual (or quarterly or monthly) payment for a tie. The difficulty begins to arise when a lump sum is paid to cover several years. If that is so then it is not so much the nature of the right acquired as the nature of the payment made for it that matters. It was argued that a rent and a premium paid under a lease are paid for different things—that the premium is paid for the right but that the rent is paid for the use of the subjects during the year. I must confess that I have been unable to understand that argument. Payment of a premium gives just as much right to use the subjects as payment of a rent, and an obligation to pay rent gives just as much right to the whole term of years as payment of a premium. A lessee who only pays rent has the same right to assign the rest of the term—perhaps for a large capital sum if values have gone up—as has the lessee who has paid a premium. But his right to assign is less valuable in so far as the amount of the rent to be paid in future is greater than it would be in a case where a premium has been paid. Both lessees are liable to have their rights terminated if they do not fulfil their obligations under the lease, but not otherwise.
- D
- E
- F

- One reason at least for refusing to allow a lump sum payment as a debit against incomings, and therefore treating it as a capital outlay, is that to allow it as a debit would distort the profit and loss account. Counsel agreed that a taxpayer is always permitted to bring the whole of any item of revenue expenditure into the profit and loss account of the year in which the money was spent. Counsel for the Crown suggested that the taxpayer might be permitted to spread it over more than one year, but certainly the Revenue cannot insist on that. So, if the whole of a payment made to cover several years is brought into one year's account, the profit for that year will be unduly diminished.
- G

- H But the effect of that will be rather different according to the length of time covered by the lump sum payment. Suppose that, in order to achieve a continuing advantage like a tie, the taxpayer makes a series of agreements each for three years and each for a lump sum. Then, if the lump sum payments are allowed as revenue expenses, the effect will be that in the first year of each

(<sup>1</sup>) 6 T.C.399.

(<sup>2</sup>) *Ibid.*, at p. 436.

**(Lord Reid)**

agreement the profit will be too small but in the next two years it will be rather too large, and so on. So over each period of three years there will be a fair result. But on the other hand, suppose that the taxpayer makes an agreement for a tie for twenty years or more, then the lump sum will presumably be much larger, and the distortion in the first year much greater if the payment is allowed as a revenue expense; and, even if one could assume fairly constant conditions for so long a period, it would be only after twenty years that a fair result would be reached. That would seem to justify refusing to treat a payment covering so long a period as a revenue expense. And on more general grounds I must say that I would have great difficulty in regarding a payment to cover twenty years as anything other than a capital outlay. Ever since the *Vallambrosa* case <sup>(1)</sup> in 1910 recurrence as against a payment once and for all has been accepted as one of the criteria in a question of capital or income. I would regard a payment which has to be made every three years to retain an advantage as a recurrent payment, whereas for practical purposes I would not think that the fact that another payment will have to be made after twenty years if the situation does not change in that time would prevent the first payment from being regarded as made once and for all.

If the asset which is acquired is in its intrinsic nature a capital asset, then any sum paid to acquire it must surely be capital outlay. And I do not see how it could matter that the payment was made by sums paid annually. But it appears to me that an asset which is nothing more than a right to enjoy a certain advantage over a period is intrinsically of a different character from a thing which a person buys and can immediately use or consume in any way he chooses. If it were not so I can see no reasonable ground for allowing annual payments for such a right as revenue expenses.

I must now turn to the authorities. In *Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.* [1964] A.C. 948 Lord Radcliffe, at page 960, said:

“Courts have stressed the importance of observing a demarcation between the cost of creating, acquiring or enlarging the permanent (which does not mean perpetual) structure of which the income is to be the produce or fruit and the cost of earning that income itself or performing the income-earning operations. Probably this is as illuminating a line of distinction as the law by itself is likely to achieve.”

Perhaps it is, but the illumination is very dim, and, as Lord Radcliffe goes on to say, it

“leads to distinctions of some subtlety between profit that is made ‘out of’ assets and profit that is made ‘upon’ assets or ‘with’ assets.”

I must say that I distrust as a guide any criterion which leads to verbal distinctions of that kind, but fortunately it is not the only guide.

The “structure” of the profit making apparatus was dealt with in *Van den Berghs’* case <sup>(2)</sup>, but the facts there were very strong, as explained by Lord Macmillan. This company and a Dutch company had long before bound themselves to “work in a friendly alliance” by an elaborate scheme and on the cancellation of their agreement Van den Berghs received a sum of £450,000.

<sup>(1)</sup> 5 T.C. 529.      <sup>(2)</sup> 19 T.C. 390.

(Lord Reid)

A This was held to be a capital receipt because<sup>(1)</sup>:

“The three agreements which the Appellants consented to cancel were not ordinary commercial contracts made in the course of carrying on their trade: they were not contracts for the disposal of their products or for the engagement of agents or other employees necessary for the conduct of their business; nor were they merely agreements as to how their trading profits when earned should be distributed as between the contracting parties. On the contrary, the cancelled agreements related to the whole structure of the Appellants’ profit making apparatus. They regulated the Appellants’ activities, defined what they might and what they might not do, and affected the whole conduct of their business.”

B I would think that the two most important of these considerations were that the contracts were not ordinary commercial contracts made in the course of carrying on the trade, and that, by defining what the company might do and might not do, they affected the whole conduct of the business. I think that in some later cases the metaphor of structure has been used with far less justification.

C *Van den Berghs’* case can be contrasted with *Anglo-Persian Oil Co. Ltd. v. Dale*<sup>(2)</sup> [1932] 1 K.B. 124, where the company paid a large sum to cancel an agency contract for a very wide area with the result that they were thereafter able to deal directly with their customers in that area. This certainly entailed an extensive change in the organisation of their business. But the payment was held to be a revenue expense because the cancellation of the agreement

“merely effected a change in its business methods and internal organization, leaving its fixed capital untouched”

D (per Lawrence L.J. at page 141<sup>(3)</sup>).

E It was argued that these ties had become part of the profit-earning structure of the Company. I do not think so. Let me take the matter stage by stage—almost as it in fact arose. First an oil company promises a rebate so long as the garage orders all its petrol from that company. Clearly there is no change in structure however many garages accept that arrangement. It is just an ordinary commercial contract. And there can be no difference if the arrangement is that £100 will be paid at the end of each quarter if the garage owner has bought all his petrol during that quarter from the company. Then suppose the parties agree to such a tie being binding for one year. That does not seem to make any relevant difference. Then suppose they agree to a three-year tie. As regards the profit-earning or capital structure of the company I do not see how it can matter how the tie is paid for—whether by lump sum or by periodical payments or by rebates. Either the tie is itself an addition to the capital structure or it is not. And I do not see how it can matter whether the company entered into such arrangements because it had to do so to keep its customers, or because it hoped thereby to attract new customers, or merely because the ties made distribution more economical. When we reach the stage that the greater part of the company’s business is done with garages under long-term ties, it could be said that the company has altered its business methods, perhaps with some internal reorganisation, but that is not the same thing as altering its profit-making or capital structure. Nevertheless, lump sum payments for these long-term ties may have to be treated as capital and not revenue expenses.

<sup>(1)</sup> 19 T.C. 390, at p. 431.    <sup>(2)</sup> 16 T.C. 253.    <sup>(3)</sup> *Ibid.*, at p. 270.

**(Lord Reid)**

Reverting to the distinction to which Lord Radcliffe referred between profits made out of or upon or with the asset, that distinction is to my mind meaningless when applied to these ties. It was argued that when there is a tie the profits are not made out of the tie but out of orders given by reason of the existence of the tie, that the tie is used as part of the capital structure of the company in order to get the orders. I do not think that that is right. When A is under a contractual obligation to B to do or refrain from doing a certain thing—here to give all his orders to B and give none to anyone else—B does not “use” his right under the contract when A does or refrains from doing that thing; he simply waits for A to fulfil his obligation. He might be said to use his right if A fails to fulfil his obligation and he then sues for damages or seeks an injunction, but that is another matter. There may be many kinds of contract under which the company has taken an obligation that the other party shall do something or a series of things in a future year, but that is no reason for saying that the company’s chose in action is an addition to its capital structure. The distinction between a right and something done under it or in exercise of it no doubt exists in other kinds of case, and it may be of importance, but it does not seem to me to exist in cases like the present case.

The case which is generally cited and relied on, often by both sides, is *British Insulated and Helsby Cables Ltd. v. Atherton*<sup>(1)</sup> [1926] A.C. 205. In order to understand the passage in Lord Cave L.C.’s speech which is always quoted, it is essential to have the facts in mind. The company laid out a sum to assist in the setting up of a pension fund for its staff. It was intended that the fund would endure for the whole life of the company and it was not expected that the company would have to lay out any further sum for this purpose. So when Lord Cave referred<sup>(2)</sup> to expenditure

“made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade”;

he was dealing with a case where the payment was made literally once and for all and where the asset or advantage was to last as long as the company lasted. I can find nothing in his speech to indicate that he had in mind or intended to deal with a case where the asset or advantage would only last for a short period of years, after which further money would have to be spent if a further corresponding asset or advantage was sought. And when in the *Vallambrosa* case<sup>(3)</sup> Lord Dunedin contrasted a thing going to be spent once and for all with a thing going to recur every year, I do not think that he had such a case in mind either.

But so much has been built on Lord Cave’s words that I must try to see how they could be applied to a case like the present. In the first place, what is the meaning of “once and for all”? Suppose that an advantage has been achieved by acquiring an asset which will only last for three years, so that it will be necessary at the end of that time to acquire another similar asset if the advantage is to be retained. I would not think that a lump sum paid for that asset is paid once and for all, and I see nothing to indicate that either Lord Cave or Lord Dunedin would have thought so. If “once and for all” is merely to be related to the fact that only one payment, a lump sum, is made for the particular short-lived asset, then the only contrast is between paying a lump sum for it and making a periodical payment for it. Surely that cannot have been all that was meant. If a further payment to retain the advantage, in this case the outlet

(<sup>1</sup>) 10 T.C. 155. (<sup>2</sup>) *Ibid.*, at p. 192. (<sup>3</sup>) 5 T.C. 529.

(Lord Reid)

A for sale of oil resulting from the tie of a particular garage, is necessary in the near future, I would hold that the first payment was not once and for all.

There is a good deal of authority on the question of what kind of asset or advantage Lord Cave's words will cover. Broadly, it seems to have been accepted that they will not extend to cover a payment to get rid of a handicap or disadvantage. But I do not think it necessary to explore this matter, because I am satisfied  
B that the words must cover a tie such as we are concerned with whether it is constituted by a simple obligation or by covenants in a sublease.

Lastly, what is meant by "enduring"? I think that Lord Cave intended to link that with "once and for all". He was thinking of a single payment for an advantage which would last for an indefinite time. I do not think he had in mind an advantage of limited duration, and I think that any decision about  
C such an advantage must be reached without reference to or reliance on what Lord Cave said.

But it was argued that "enduring" has come to be interpreted so as to include any benefit which lasts for more than one year and that this was recognised in the *Nchanga* case<sup>(1)</sup>. If this is an interpretation of Lord Cave's words where "once and for all" is coupled with "enduring", then the supposed rule  
D must be that any lump sum paid for a benefit enduring for more than one year must be treated as a capital outlay—not that any asset conferring an enduring benefit is intrinsically a capital asset. For if it were intrinsically a capital asset then any payment for it, whether by a lump sum or by a series of periodic payments, must be a capital outlay, and so far as I know it has not been suggested that, say, monthly payments for any asset the benefit of which endures for  
E more than a year must all be treated as capital outlays. Certainly that could not be spelled out from Lord Cave's words. I have searched in vain for any rational explanation of this supposed rule, so apparently it must just be an arbitrary rule. But, as I have already explained, arbitrary rules are quite out of place in this matter of capital or income.

One argument has been put forward to justify the rule. When a trader's  
F accounts come to be made up at the end of his financial year and the trader is then found to own an asset other than circulating capital or stock-in-trade, it is said, if I understand the argument, that that asset must go into the balance sheet as a capital asset and the price paid for it must therefore have been a capital outlay. But, even if correct, that argument would not support this alleged rule. Let me suppose that in the first month of his financial year the trader acquired  
G an asset conferring a benefit lasting for 15 months, and that in the last month of that year he acquired a precisely similar asset conferring a benefit lasting for six months. Then at the end of the financial year he has two similar assets, the first of which will last for a further four months and the second of which will last for a further five months. Why should they then be treated differently? But if this supposed rule exists they must be treated differently. The first, being  
H "enduring"—bringing a benefit lasting more than a year—must go in the balance sheet; but the second, not being "enduring", need not, and the price paid for it can be treated as a revenue expense. A variant of this argument is that a right which comes to an end during the financial year current when it is acquired is not enduring, but that any right which persists into the next financial year must be regarded as enduring. But that would mean that a right lasting for ten

(<sup>1</sup>) [1964] A.C. 948.

**(Lord Reid)**

months would not be enduring if it was acquired during the first month of the financial year; whereas a similar right lasting for only three months must be held to be enduring if it was acquired in the last month of the financial year. But that would be absurd. These arguments, far from justifying the rule, merely go to show how arbitrary it is. I am satisfied that no such rule exists or could be supported.

In the *Nchanga* case<sup>(1)</sup> their Lordships sought to distinguish *John Smith & Son v. Moore*<sup>(2)</sup> [1921] 2 A.C. 13, and some of Lord Radcliffe's observations are said to support the supposed rule. I do not think they do. *Smith's* case was not relied on by the Crown in this appeal, but I must try to shew why it does not affect this matter. A son bought the whole assets of his father's business at a valuation and continued to carry on business as a coal merchant. Those assets included contracts by which he was entitled to buy coal in future at a fixed price. As the price of coal had risen since the contracts were made, the rights under the contracts had become very valuable—they were valued at £30,000. The trader claimed that this sum had been spent to acquire stock-in-trade, but that claim failed. Lord Cave held that there was a continuing business, and his reasons are not material in this connection. But Lord Haldane and Lord Sumner appear to have regarded the son as setting up a new business. Their reasoning is not always easy to follow, but on that basis the essence of the matter appears to me to be this. What a person spends to set up a business must be capital; there cannot be a revenue expense until trading commences, and the son did not claim this sum as a revenue expense. But the prospective merchant buys two things, stock-in-trade which he intends to sell—circulating capital—and other property or assets which must be regarded as fixed capital. The sum he spends on buying stock-in-trade goes into his first profit and loss account as the value of stock-in-trade at the beginning of his first year. But the rest can only go into his balance sheet. So the former sum is taken into account in determining his first year's profit but the latter is not. All that the case decided was that, if a new trader acquires goods which he intends to resell, those goods are stock-in-trade; but if he acquires rights to buy such goods those rights cannot be treated as part of the stock-in-trade with which he begins trading. That seems to me to be perfectly sound.

In my view the decision in *Smith's* case has no application to what a trader does once he has started trading. Suppose that a merchant, instead of buying goods direct from the manufacturer, takes from another merchant an assignment of his contract to buy such goods. The goods may be for delivery next week (or next year). It would be ridiculous to say that the sum which he pays to the other merchant is a capital outlay and not a revenue expense, and I can find nothing in the speeches in *Smith's* case to indicate that anyone thought otherwise. Lord Sumner, indeed, indicated that it would be different for a going business. He said, at page 39<sup>(3)</sup>, dealing with an earlier similar case:

“The Court held that this sum was paid with the rest of the aggregate price to acquire the business and thereafter profits were made in the business; the sum was not paid as an outlay in a business already acquired, in order to carry it on and earn a profit out of this expense as an expense of carrying it on.”

(<sup>1</sup>) [1964] A.C. 948.      (<sup>2</sup>) 12 T.C. 266.      (<sup>3</sup>) *Ibid.*, at pp. 296–7.



(Lord Reid)

A It must be observed that the contracts purchased by the son in *Smith's* case<sup>(1)</sup> were all very short term contracts. As Lord Finlay said<sup>(2)</sup>,

“the contracts purchased all expired by the end of the current year”.

So *Smith's* case is no authority for drawing a distinction between assets which last less than a year, or which come to an end during the current accounting period, and assets which last longer. On the contrary, if *Smith's* case had any

B application to the acquisition of short-lived assets by a going business, it would require us to hold that even the cost of acquiring assets which cease to exist before the end of the current year is a capital outlay.

I do not think it necessary to survey all the cases cited in argument. Many deal with matters in no respect analogous to this case. There is, for example, the group of cases where payments to obviate competition were held to be capital outlays. If you buy a business either to operate it or to close it down, if you pay a competitor to close down, or if you buy off a potential competitor, the cost may well be a capital outlay. And so may certain preliminary expenses which you must incur before you can begin trading. In these and other cases cited I can find no established doctrine contradicting the observations which I have already made. But there are some cases on which I must comment.

D Both sides in this case argued that *Bolam v. Regent Oil Co. Ltd.* 37 T.C. 56 was rightly decided, but they drew entirely different conclusions from it. The Appellants used it to support an argument that any payment for any tie, however long, is a revenue payment. The Crown argued from it that any payment for a tie in the form of rebate—even a lump sum paid in advance for a long period of years—is a revenue payment, but that any kind of lump sum payment must be a capital payment even if only paid for a tie for two or three years. I cannot agree with either argument. The Crown's argument appears to me to lead to an irrational result. It is true that form as well as substance is often important, but I cannot think that the way in which the price paid for an asset is calculated can make so much difference as their argument requires. And the Appellants' argument totally ignores the practical differences between allowing as a revenue expense a lump sum to cover the next two years and a lump sum to cover the next twenty.

G The longest ties in *Bolam's* case were for five or six years. A business cannot simply be managed on a day-to-day basis. There must be arrangements for future supplies and sales, and it may not be unreasonable to look five or six years ahead—one hears of five-year plans in various connections. So I would think that making arrangements for the next five or six years could generally be regarded as an ordinary incident of marketing, and that the cost of making such arrangements would therefore be part of the ordinary running expenses of the business. Moreover, a payment which will have to be repeated after five years to retain the tie can, I think, be regarded as a recurring payment. And there is no serious distortion of the profit and loss account for that period if payment for a five-year advantage is made in a lump sum instead of being spread over the period. For these reasons I think that the decision in *Bolam's* case was right.

H It was argued that *Henriksen v. Grafton Hotel Ltd.*<sup>(3)</sup> [1942] 2 K.B. 184 was authority for the proposition that a payment which is made for an asset

(1) 12 T.C. 266. (2) *Ibid.*, at p. 288. (3) 24 T.C. 453.

**(Lord Reid)**

lasting three years, and which will then have to be repeated to acquire a new asset for the same purpose, is not a recurring payment and must be treated as a capital outlay. But Lord Greene, M.R., laid stress on the special features of that case, and I need not consider whether they were sufficient to justify the decision. If and in so far as the *ratio decidendi* was based on any such general proposition I would not agree with it. A

There was reference in the judgments below to *H. J. Rorke Ltd. v. Commissioners of Inland Revenue*<sup>(1)</sup> 39 T.C. 194 and earlier similar cases. But as Counsel did not found on them before your Lordships, I shall only say this. I think that the decision of Upjohn J. in *Knight v. Calder Grove Estates* (1954) 35 T.C. 447 was right because there land was purchased. But there are expressions of opinion in other cases which appear to conflict to some extent with what I have already said. Again I need not consider whether the decisions were right. B C

In two of the four arrangements with which the present case is concerned (including much the largest transaction) the ties were for twenty years; in one the tie was for ten years; and in the fourth it was for five years. I would have no doubt that the lump sums paid for the twenty-year ties could not be treated as revenue outgoings even if there were no lease and sublease. These ties were not obtained in order to facilitate planned marketing, or because the Appellants thought it desirable to have them. The lump sums paid for them were only paid because garage owners were in a strong bargaining position: they wanted and were able to get large sums paid immediately, and they were willing to grant long ties in return. D

But with regard to the other two cases I must consider what difference it makes that the transaction took the form of a lease and sublease. This is not a mere matter of form, because this form of transaction gave to the Appellants much better security for the performance by the garage owner of his obligation, and it gave to them interest in land which afforded that security. So the quality of their asset is different from what it is under the older form of tie. I have already said that all relevant factors must be considered in each particular case, and I regard this as a highly relevant factor. E F

Premiums paid for leases have always been regarded as capital, but we were not referred to any case where a premium had been paid for a very short lease—say two or three years—and I do not wish to decide whether even in such a case a premium would necessarily be treated as a capital outlay. But I am satisfied that the weight of this factor in the present cases is sufficient to turn the scale if otherwise there were doubt, and I would therefore hold that in each of the four cases the lump sums paid by the Appellants cannot be allowed as revenue outgoings. It follows that these appeals must be dismissed. G

**Lord Morris of Borth-y-Gest**—My Lords, on the facts as found in the Stated Case I consider that the lump sum payments which were made by the Appellants were of a capital and not of a revenue nature. I am of this opinion for two reasons. The first is that each payment was made as the price of acquiring an interest in land which was an asset of a capital nature. The leases were granted to and accepted by the Appellants on the basis that there would be subleases to the lessors, and that in the subleases there would be covenants which obliged H

(<sup>1</sup>) [1960] 1 W.L.R. 1132.

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A the lessors to obtain all their supplies of petrol from the Appellants. There were other covenants, such as those which compelled the lessors to carry on business or to bring it about that an assignee would likewise be compelled to and would obtain all his supplies from the Appellants. The circumstance that in taking a lease and in granting a sublease the concern of the Appellants was to secure a purchaser for the petrol which they, as wholesalers, wished to sell does not alter the fact that there was a real, and not a sham, transaction under which, in return for the payment of a sum of money (it matters not whether it be called a lump sum payment or a price or a premium), a lease of land for a period of years (at a nominal rent) was obtained. The leases were of considerable value to the Appellants because they (the Appellants) were as a result enabled to grant subleases containing the covenants which for trade reasons they were anxious to obtain. Provisions in regard to forfeiture gave a measure of security to the Appellants.

I agree with the view expressed by the learned Judge and by the Court of Appeal that the Appellants acquired interests in land and that such interests were of a capital nature; I agree also that in the circumstances of the present case the payments made to acquire those interests must be regarded as being payments of a capital nature. The fact that the payments were agreed upon after calculations made by reference to estimated gallonage does not alter the fact that they were lump sum payments in order to acquire interests in land which, though they were only to endure for periods of years, should be regarded as capital assets. The fact that the "lease-sublease" arrangements made by the Appellants were few in number as compared with other arrangements which were comparably motivated I regard as irrelevant.

I also arrive at the conclusion that the payments were of a capital nature for a second reason. It is one which I understand does not commend itself to the majority of your Lordships. In the Case Stated it is said:

"At the end and as a result of the two transactions of lease and sublease, which were firmly linked together, Regent had paid a sum of money for a valuable right, namely the exclusive right to have its oil sold at the station for a given period."

If in a business sense each "lease-sublease" arrangement is to be regarded as the method whereby for a lump sum payment the Appellants acquired an exclusive right to a dealer's custom for five years or for ten years or for 21 years, then I consider that such lump sum payment was of a capital and not of a revenue nature. I agree with Lord Denning M.R. when he said<sup>(1)</sup>:

"[Regent] say to the retailer, 'We will pay you £5,000 if you will sell our products exclusively at this point for five years', or ten or 21, as the case may be. [Regent] make a payment once and for all. In return they get an advantage which is of enduring benefit to them. It brings in revenue to [Regent] week after week, and month after month, from the petrol they supply to the retailer. I have no doubt this advantage is a capital asset and the payment for it is capital expenditure."

The facts recounted in the Case Stated show that in recent years the large suppliers of petrol, being impelled by the stern thrust of competition, have felt obliged to secure exclusive outlets for their petrol. In what has been called the

<sup>(1)</sup> See page 18, *ante*.

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“exclusivity war” there have been arrangements of varying nature. For the purposes of the present case it will suffice to examine the nature of a payment made if there were acceptance by a garage owner of an offer expressed in some such terms as “If we pay you £5,000 will you promise to obtain all your petrol from us for the next five years?” The payment would in my view be of a capital nature.

In arriving at this conclusion no recourse can be had to statutory definition, for such there is not. The decided cases, carefully marshalled in argument, show that in the diverse and varying sets of circumstances in which decision has been called for as to whether payments have been of capital or of revenue nature no all-embracing formula has been evolved. No touchstone has been devised. Where definition is lacking then description must do its best. In giving the judgment of the Privy Council in *Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.* [1964] A.C.948 Lord Radcliffe, in referring to phrases used in earlier cases, said that it had to be remembered that they were “essentially descriptive rather than definitive”. The decided cases are to be scanned because they contain pointers and mention factors and give indications and provide descriptions. Care must, however, be taken not to take phrases which are uttered in relation to particular facts and then to promote them to be of universal application.

In some cases payments can by general assent be recognised at once as being either of capital or of revenue nature. Where dispute arises a court must do its best to assess the value and the weight of all the particular features which may point to one conclusion or the other and, in doing so, to have in mind the legal image which a wealth of judicial utterance reveals.

In this approach there must be a measure of reluctance in referring to some only of the decided cases lest it be thought that the guidance afforded by others is being neglected. The well-known words of Viscount Cave L.C. in *British Insulated and Helsby Cables Ltd. v. Atherton*<sup>(1)</sup> [1926] A.C. 205 are perhaps so often quoted because in a single sentence reference is made to a number of features or attributes. Some of these may be valuable as pointers some of the time provided it is not assumed that all are useful all the time. It may in some cases be of some significance that a payment is made “once and for all”. This thought was earlier expressed by Lord President Dunedin in *Vallambrosa Rubber Co. Ltd. v. Farmer* 5 T.C. 529 at page 536, when he said that

“in a rough way”—the words denote that he was speaking in general terms —“I think it is not a bad criterion of what is capital expenditure as against what is income expenditure to say that capital expenditure is a thing that is going to be spent once and for all, and income expenditure is a thing that is going to recur every year.”

The notion of a payment being made “once and for all” may perhaps in some cases suggest the payment of the price of something of a capital nature, but like any other individual phrase it must be of only limited application and helpfulness. It must be remembered also, as Lord Dunedin pointed out in the *Vallambrosa* case (see page 534), that it would be wrong to say that each year must be taken absolutely by itself and that nothing could ever be deducted as an expense unless it was purely and solely referable to a profit reaped within the

<sup>(1)</sup> 10 T.C. 155, at p. 192.

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A year. The necessary annual outgoing to cover the necessary annual weeding of a rubber estate would seem essentially to be of the nature of a revenue outgoing.

It may further be of some significance, as Lord Cave pointed out, if as a result of a payment something is brought into existence which is an "asset or an advantage" and if it is "for the enduring benefit of a trade".

The process of description as opposed to that of definition may sometimes be aided by noting contrasts. There is a difference between a business entity, structure or organisation set up or established for the earning of profit and the process by which such an organisation operates to obtain regular returns by means of regular outlay. There is a difference between the profit-yielding subject and the process of operating it. There is a difference between the instrument for earning profits and the continuous process of its use or employment for that purpose. These contrasts were noted in 1938 by Dixon J. in his judgment in *Sun Newspapers Ltd. v. Federal Commissioner of Taxation* 61 C.L.R. 337, at page 359. In much the same way in 1946 in his judgment in *Hallstroms Pty. Ltd. v. Federal Commissioner of Taxation* 72 C.L.R. 634, at page 647, Dixon J. distinguished between the acquisition of the means of production and the use of them; between establishing or extending a business organisation and carrying on the business; between the implements employed in work and the regular performance of the work in which they are employed; between an enterprise itself and the sustained effort of those engaged in it. In his judgment in that case Starke J., at page 644, while emphasising that none of the so-called definitions or tests or any other definitions or tests suggested by the cases are decisive, pointed out that an asset or advantage need not have a tangible existence, and expressed the view that expenditure to acquire the goodwill of a business or to acquire restrictive covenants against competition in business may be of a capital nature. In agreement with what was said by Starke J., I consider that no different result is reached according as to whether an asset or advantage is of a tangible or of an intangible nature.

The contrast has been observed between expenditure forming

F "part of the cost of improving or adding to the income earning plant or machinery" and "part of the cost of performing the income earning operations":

see *New State Areas Ltd. v. Commissioner for Inland Revenue* S.A.L.R. [1946] A.D. 610, at pages 620-1.

G An analogous contrast may be that between plant, on the one hand, and stock-in-trade, on the other. In *Hinton v. Maden & Ireland Ltd*<sup>(1)</sup> 38 T.C. 391, at page 417, Lord Reid said that the word "plant" might have a more or less extensive meaning according to its context but that as a general statement of its meaning he would adopt the words of Lindley L.J. in *Yarmouth v. France* (1887) 19 Q.B.D. 647, at page 658:

H "in its ordinary sense, it includes whatever apparatus is used by a business man for carrying on his business—not his stock-in-trade which he buys or makes for sale; but all goods and chattels, fixed or moveable, live or dead, which he keeps for permanent employment in his business".

In like manner it can be said that there is a difference between money spent in creating or acquiring a source of profit and money spent in working it.

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In the *Nchanga* case<sup>(1)</sup>, Lord Radcliffe, at page 960, said that

“courts have stressed the importance of observing a demarcation between the cost of creating, acquiring or enlarging the permanent (which does not mean perpetual) structure of which the income is to be the produce or fruit and the cost of earning that income itself or performing the income earning operations.”

In *Robert Addie & Sons' Collieries Ltd. v. Commissioners of Inland Revenue*<sup>(2)</sup> 8 T.C. 671, at page 676, Lord President Clyde posed the question:

“[Are the sums in question] part of the trader's working expenses?—[are they] expenditure laid out as part of the process of profit-earning?—or, on the other hand, [are they] capital outlays, [are they] expenditure necessary for the acquisition of property or of rights of a permanent character the possession of which is a condition of carrying on the trade at all?”

The contrast so noted was referred to in deciding *Commissioners of Inland Revenue v. Adam*<sup>(3)</sup> 14 T.C. 34. In that case a carting contractor found it expedient for the purposes of his business to acquire a site for the deposit of waste soil removed from building foundations. He achieved his purpose without purchasing the site, by means of a contract with the owner of the site. He was given the right (and he undertook the obligation) to deposit soil on a defined area at a stated rate per annum for a period of eight years. For the right he agreed to pay the owner the sum of £3,200 payable in “instalments” (“to account thereof in advance”) of £200 each in June and December of each year. It was held that the £3,200 was a payment for a capital asset and that no deduction by reference to it was admissible for income tax purposes. The lump sum of £3,200, though payable by instalments over a period of eight years, was of a capital nature. In his judgment Lord President Clyde said, at page 41:

“A great deal has been said about form and substance. I think that, in a question of this sort, both form and substance must be considered; because the form of the transaction by which the Respondent acquired the right to dump waste soil may bear very materially on the question of the capital or revenue character of the outlay made to acquire it. Suppose that the consideration for the right had been an annual rent of the site stipulated for as such, it would, I think, have been difficult to displace the view that the rent was a proper revenue charge. But (the contract taking the form it does) it is equally difficult to put out of view the fact that the consideration is not a rent but a capital price.”

In a case in which the nature from the retailer's point of view of a money payment received by a retailer for a tie was being considered, *Commissioners of Inland Revenue v. Coia*<sup>(4)</sup> 38 T.C. 334, Lord President Clyde, at page 339, said that it was

“as the consideration for his giving up his freedom of trading and changing the structure of this part of his business”.

Lord Patrick said, at page 339, that

“he parted with what I regard as a valuable asset of a capital nature, the right to obtain the supplies of fuel oils which were his stock-in-trade from

(1) [1964] A.C. 948.

(2) 1924 S.C. 231.

(3) 1928 S.C. 738.

(4) 1959 S.C. 89.



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A such sources as he might consider most suited to the varying nature of the demands made by his customers”.

Lord Mackintosh, at page 340, said that the tie plainly

“affected the overall structure of Mr. Coia’s garage business. He became henceforth for a ten-year period tied to . . . for all his supplies instead of being at liberty from 1953 onwards to buy and sell all the particular brands of motor fuel which were then on the market.”

B The decision in *Bolam v. Regent Oil Co. Ltd.* 37 T.C. 56 has not been assailed by the Crown. That case differs from the present ones if the payments in that case can be regarded as having been rebates or discounts made in reference to the amount of petrol sold to the retailers in each year. In his judgment Danckwerts J. said<sup>(1)</sup>:

C “It seems to me that there would have been no doubt if the payments had been made by reference to the amount of petrol sold to the retailers in each year; it would plainly have been expenditure, particularly if paid in the form of a rebate, which was expended by the Regent Oil Co. in the course of its trade in the making of its profits. Does it make a difference because in the circumstances of the case there has to be some lump sum fixed which is paid to secure the same result, and even if payment is made in advance for several years?”

E In examining the nature of the payments which were made and which are in issue in this case it is important to consider, not so much why the payments were made, but for what they were made. If the motive in making payments is noted or becomes manifest, the more relevant enquiry must be made as to whether some asset or advantage was acquired, and if so what was its nature. It is said that the Appellants, as a matter of hard business necessity, were forced, in the instances now being considered, to do what they did. Their rivals and competitors would or might have made “lease-sublease” arrangements with the particular garage owners had the Appellants, somewhat reluctantly, not acted as they did. So also it is said that “tie” arrangements had become a necessity for the petrol-selling companies and had become a regular and customary part of the pattern of business arrangements. Accordingly, so the argument runs, the payments made were reasonably to be classified as being selling or marketing costs and as such to be regarded as of a revenue nature. My Lords, in my view the conclusion does not follow from the premise. The fact that a payment must in prudence be made does not show that it is of an income rather than of a capital nature. Nor is the enquiry in any way advanced by saying that a payment was necessarily made in the course of the process of marketing or was made in conformity with the accepted or customary pattern of trading. It is common ground that the sums of money now under consideration were expended wholly and exclusively for the purposes of the Appellants’ trade. It can also be taken for granted that all sums that the Appellants spent in the course of marketing were spent because they considered that it was necessary to spend such sums in order to help them to sell their petrol. But to call such sums marketing costs is merely to apply a neutral or generic description which in no way distinguishes between payments of a capital nature and payments of a revenue nature. Some marketing costs are of the one kind and some are of the other. It may become

(1) 37 T.C., at p. 68.

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imperative for the purpose of effecting sales to acquire a building which is to be used solely for such purpose; the cost of acquiring the building would not be an expense of a revenue nature. What falls to be considered is the nature of that for which payment has been made. In the selling side of their business the Appellants were marching in step with their competitors and had to embark upon much expenditure. In one sense all of it was a selling or marketing expense. It all took place in the hope and the expectation that sales would be induced. Some of it, however, would be of a capital nature and some of a revenue nature. The important consideration is the character of the advantage which, by the expenditure, it is sought to obtain: see Dixon J. in *Sun Newspapers Ltd. v. Federal Commissioner of Taxation*<sup>(1)</sup>.

In considering the nature of a payment it may well be relevant to know whether similar payments will recur and whether the payment is but one of a number of periodic payments. Here again it becomes important to consider what it is that the items of payment will produce. Some capital assets may last but a short time. They do not for that reason lose their character as capital assets. If they are much needed, so that a succession of them must be obtained, there will be periodic or constantly recurring payments of money. Yet each of these payments will be of a capital nature. If the nature of what is acquired makes it a capital asset the payment for it will be a capital payment. If tangible assets (such as the knives or lasts in *Hinton v. Maden & Ireland Ltd*<sup>(2)</sup>) are clearly capital assets, then the payments for them are capital payments even if the useful life of the assets is shorter than the length of an accounting period.

The fact that there are payments, seemingly of the same nature, which appear to be recurrent may be a circumstance to be examined in deciding as to the nature of the payments. If in a business a particular capital asset must be acquired, then the fact that in a similar but larger business many of such capital assets will be needed will be an immaterial circumstance. So also will it be immaterial whether a number of such capital assets are bought all at one time or whether they are bought over a period of time. Their character as capital assets will not change if many are bought rather than few, or if they are periodically bought and periodically paid for. The fact or recurrences of payments will be of no consequence; nor will recurrences of orders. Similarly, if for the purposes of some manufacturing process, articles are purchased which are to be worked upon in a factory, so that when fashioned and altered they will be finished products which are then to be for sale, the sums paid to purchase such articles will have a revenue nature which will not change even if, instead of there being successive or periodic purchases, there are occasional purchases of large quantities.

If a tie of the nature that I am examining is properly to be regarded as an asset of a capital nature, and if the payment made for it is to be regarded likewise, then I cannot think that these conclusions are altered or affected by the circumstance that some thousands of ties may be acquired.

Although a Court must not be deluded if by the mere form of a transaction its substance is masked or shrouded, there are some transactions which may be done either in one way or in another way, and in which form may denote and point to substance. There may well be a difference between a case where a lump

<sup>(1)</sup> 61 C.L.R. 337, at p. 363.      <sup>(2)</sup> 38 T.C. 391.

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- A sum payment is made to acquire the right to occupy premises for a period (say) of 21 years and a case where by contract a right is acquired to occupy premises for 21 years with an obligation to make periodic payments for such right to occupy. In the latter case the periodic payments, being periodic payments for the use of premises, would probably be payments of a revenue nature. In such a case the right itself to go on occupying the premises, subject to making the periodic payments or subject to conditions, might be or become of considerable value. It would be a capital asset, but as no lump sum price would have been paid for it there would be no payment of a capital nature: there would be no payment calling for any enquiry.

- Aided by the word pictures or descriptions of a capital asset which the decided cases contain, I consider that a tie of the kind now being examined is a capital asset. If a lump sum is paid for such a tie for five years (or for a lesser number of years), it would give a false and unreal picture if the whole sum were debited to the profit and loss account for the first year or for the year in which the payment was made. If it is said to be hard that no part of the lump sum can be a debit in the profit and loss account, that is merely to voice a regret that there is no statutory provision which enables periodic allowances to be made. That, however, is not a matter for the Courts.

- If regard is had to the language of metaphor which is found in some of the cases, a tie would seem to appertain to the "structure" of the selling organisation or income-earning machine of the Appellants. If it is argued that a tie for a shorter period than a year may seem to possess the same nature as a tie for a longer period, I think that it can be said that a tie for a period of less than a year (being a right which so to speak evaporates within the year) is so closely linked with the selling operations during that year that it becomes different in nature and does not qualify to attain "the dignity of a capital asset": see *Henriksen v. Grafton Hotel Ltd.*<sup>(1)</sup> [1942] 2 K.B. 184. In that case it was held that payments in respect of the monopoly value payable upon the grant of a licence for a period of three years were of a capital nature. Du Parcq L.J. said, at page 196<sup>(2)</sup>, that

"the right to trade for three years as a licensed victualler must be regarded as attaining the dignity of a capital asset".

Lord Greene M.R., at page 192<sup>(3)</sup>, said:

- "A payment of this character appears to me to fall into the same class as the payment of a premium on the grant of a lease, which is admittedly not deductible. In the case of such a premium it is nothing to the point to say that the parties, if they had chosen, might have suppressed the premium and made a corresponding increase in the rent. No doubt they might have done so, but they did not do so in fact. The lessee purchases the term for the premium. There is no revenue quality in a payment made to acquire such an asset as a term of years."

- H The Appellants were doubtless reluctant to have to incur the expense of purchasing a number of ties, but they saw no alternative. They felt obliged, on certain sites, to purchase an "umbrella" within and under the protection of which they could conduct their selling operations for a period of years. Further to vary the metaphor, they felt obliged to purchase a "tree" which would live

<sup>(1)</sup> 24 T.C. 453.

<sup>(2)</sup> *Ibid.*, at p. 462.

<sup>(3)</sup> *Ibid.*, at p. 460.

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for a period of years; its “produce or fruit” would be the orders that would result year by year during the period. A

If the Appellants had paid a sum of money to a rival company or to rival companies, i.e., to one or more of the other big petrol selling wholesalers, in exchange for promises that it or they would not over a period of years sell petrol to a particular retailer, such payments would, I consider, be of a capital nature: cf. *United Steel Companies Ltd. v. Cullington* (1939) 23 T.C. 71; *Collins v. Joseph Adamson & Co.*<sup>(1)</sup> [1938] 1 K.B. 477, and *Sun Newspapers Ltd. v. Federal Commissioner of Taxation* 61 C.L.R. 337. The position must surely be the same if, instead of the payment being made to the rivals, it is made to the retailer. (I enter into no consideration of any contentions not now relevant that might possibly be raised in regard to any such arrangements.) B

For the reasons that I have indicated I consider that the payments were of a capital nature. I would dismiss the appeals. C

**Lord Pearce**—My Lords, it is contended that the transactions here in question can be equated to the payment by a wholesaler to a retailer of a lump sum in advance to secure his entire custom for a period. If that were possible, the considerations pointing towards a revenue expenditure would, in my opinion, have prevailed on balance in the transaction where only a five-year period is involved. But they would probably have failed to do so in the two transactions which relate to periods of 21 years, and which thereby acquire a more enduring and structural quality. D

But no such equation is possible. A lease-sublease transaction is materially different both in form and in substance. By it the wholesalers obtain for a premium an interest in the land from which their goods are retailed to the public. Admittedly they have bound themselves to sublet, and therefore their right to possession, like that of any leaseholder who sublets for all save three days of his lease, will probably be minimal. Breaches of covenant, however, might put them into possession; and in that case they would be in possession of land which they could sublet. And throughout the period of the lease, although not in possession, they have, not merely a personal covenant by a retailer, but an interest in land through which they can enforce its use in a way beneficial to themselves. E F

The acquisition of such an interest in land points strongly to a capital expenditure and, on the facts of these cases, dominates other indications. This indication of a capital expenditure is not diminished by the argument that the wholesalers might have obtained the substance of what they wanted by a revenue payment and without purchasing an interest in the land. They did not do so. Instead they chose to enter into these particular arrangements, which were not shams but genuine commercial transactions. They entered into them in order to satisfy insistent customers who were anxious to produce genuine transactions which would render the sums paid to them capital receipts in their hands. There seems no justification for regarding these transactions as other than in fact they were, or for treating them as anything but acquisitions of leases for premiums with the object of obtaining trade ties. The fact they they were acquisitions of leases tilts the balance in favour of regarding the premiums as capital payments. G H

<sup>(1)</sup> 21 T.C. 400.

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A I agree, therefore, with your Lordships and with the Courts below, that the sums in question could not be deducted from the Appellants' assessable income for tax purposes, and I would dismiss the appeals.

**Lord Upjohn**—My Lords, the relevant facts are set out fully in the Case Stated and in the judgments in the Courts below, and it is unnecessary for me to say more than a few words as a background to my judgment.

B Ever since the war there has been intense competition between the importers and suppliers of petrol in this country. From 1951 onwards a system of trading has grown up, so that it is now admitted to be a custom of the trade, whereby each of the great oil companies supplies exclusively its own brand of petrol to garage proprietors supplying the public and in return the garage proprietor (to whom I will refer as the dealer) undertakes to buy all his petrol requirements from that particular supplier. This is known in England as the exclusivity system and in Australia as the solo site system. So intense is the competition between suppliers that the dealers have the whip hand, in that post-war unusual thing, a strong buyer's market. The suppliers have to pay the dealers sums of money in order to persuade them to take their own particular petrol exclusively in preference to that of their competitors. This has developed over the years, and the history of the matter is set out fully in the judgment of Lord Denning M.R.<sup>(1)</sup> [1964] 1 W.L.R. 1166, at page 1172, and I do not propose to repeat it.

For the relevant years of assessment, 1957-58 and 1960-61, this stage had been reached. The Appellant Company, to whom I will refer as "Regent", were supplying petrol to rather over 4,500 stations, of which some 90 per cent. were tied exclusively to Regent. Of this 90 per cent., or roughly speaking 4,000, there were but four dealers who were tied to take Regent's petrol exclusively by means of a transaction known as lease and sublease, which I shall have to examine in a little detail later. All the rest were bound by what I may describe as long-term trading agreements, that is to say, Regent paid to the dealer a lump sum down upon the terms that he would buy his petrol requirements exclusively from Regent for a term of years. This term varied from three to ten or more years, but on the average seems to have been about five years. These ties were no more than long-term trading agreements and Danckwerts J. had decided in *Bolam v. Regent Oil Co. Ltd.* 37 T.C. 56 that the lump sums paid by Regent in respect of those agreements were trading expenses of a revenue nature which were deductible in ascertaining Regent's profits for the year. The correctness of the decision in *Bolam's* case was not challenged by the Crown before your Lordships.

The lease-sublease method of tie may be explained by taking one example from the Case Stated, that of Green Ace Motors Ltd. This arrangement was made by two documents, admittedly all part of one transaction. The first document was a lease dated 11th June 1956 between Green Ace Motors Ltd., referred to as "the dealer", of the one part, and Regent, of the other part, whereby the dealer, in consideration of the sum of £5,000 then paid by Regent, demised to Regent the dealer's garage premises at Ipswich for a term of ten years at the nominal rent of £1 per annum. Regent entered into a number of covenants usual in a lease. The second document of the same date was a sublease made between Regent, of the one part, and the dealer, of the other part, whereby

(<sup>1</sup>) See pages 16-17, *ante*.

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Regent, in consideration of the rent reserved and of the dealer's covenants, demised to the dealer the garage premises for the term of ten years less three days at a rent of £1 per annum. The dealer entered into a number of covenants usual in a lease, and in addition a number of special covenants to continue to carry on on the premises the business of a dealer, to have Regent's brands of motor fuel available at all reasonable times so long as Regent was willing and able to supply him with fuel, to purchase its total requirements of motor fuel from the Company, and not sell any motor fuel supplied by any other company on those premises or any adjoining premises owned or occupied by the dealer. The dealer also entered into certain covenants with regard to advertising Regent's products on the premises. There was the usual proviso for re-entry on breach of any covenant. It was an essential part of this agreement, and a circumstance strongly relied upon by Counsel for Regent, that the sum of £5,000 was calculated by reference to the gallonage which it was expected would be sold at the station during the currency of the sublease. At the date of that transaction the petrol suppliers were in general granting a rebate of 1d. a gallon for exclusive rights, and the sum of £5,000 was based on an anticipated sale of 1,200,000 gallons at the station during the period of the sublease. By a supplemental agreement it was provided that, if the dealer did not sell as much, he would not have to repay anything, but if more was sold he would get an extra 1d. per gallon on the extra amounts sold.

It is only with the four lease-sublease transactions that this appeal is concerned and it will be convenient if I set them out.

<i>Company</i>	<i>Lump sum payable on executing the lease to Regent</i>	<i>Term of the lease</i>
	£	
1. Green Ace Motors Ltd. . . . .	5,000	10 years
2. C. V. Clapp Ltd. . . . .	2,083	5 years
3. Stadium Motor Works, Belfast	10,416	21 years
4. Murphy . . . . .	27,000	21 years

There were differences of detail between these transactions, which are examined fully in the Case Stated, but these differences are immaterial; the premium was in every case calculated according to gallonage anticipated to be sold during the period of the tie. The transaction with Mr. Murphy was a little different. He owned a number of sites in south-east London where he was proposing to build petrol sites. He covenanted to build petrol stations on these sites; this circumstance, however, has not been treated in argument as relevant to the question of capital or income. The Murphy case I have stated above was typical of a number (about a dozen) of lease-sublease transactions between Mr. Murphy and Regent which were carried out at about this time (1959) between a number of subsidiary companies promoted by Mr. Murphy and Regent.

Why was this new form of transaction invented in these few cases? For the simple reason, as appears quite clearly from the Case Stated, that these particular dealers were not content to receive lump sums under the *Bolam*<sup>(1)</sup> form of trading agreement which had been decided to be deductible expenses

(<sup>1</sup>) 37 T.C. 56.



(Lord Upjohn)

- A in the hands of Regent and might, therefore, have to be treated as trading receipts of a revenue character in the hands of the dealer. We were referred to a number of authorities on the taxable character of the receipt; they are not entirely satisfactory and it is not necessary to review them. So strong was the position of the dealers, however, that they could insist that the lump sum to be received by them should be received in a form which they believed would
- B clearly be non-taxable—that is, a premium for the grant of a lease—and Regent reluctantly accepted this type of transaction.

- It was fundamental to Mr. Borneman's argument on behalf of Regent that these transactions, although taking the form of lease and sublease, were in fact nothing more than a continuation of the ordinary trading methods common to the trade, and it was said that these premiums paid upon the execution of each
- C lease were nothing more than ordinary marketing costs incidental to the ordinary operation of day-to-day selling of Regent's petrol. He submitted that the lease procedure, where the premium was tied arithmetically to anticipated gallonage, was no more than a vehicle to provide for payment to the dealer of sums analogous to a rebate on the price which the dealer would in any event obtain for exclusivity. He submitted that Regent had no interest in obtaining an interest
- D in land and that the three days' reversion at the expiry of each sublease was purely nominal. He therefore invited your Lordships to say that this lease and sublease procedure was no more than a cloak which you must pierce, when you would find that the true nature of the transaction was no more than a perfectly ordinary trading arrangement which provided a rebate over a long trading period. He submitted that it matters not whether the tie was for three months
- E or twenty years. That is only a measure to fix the premium by an arithmetical calculation to work off the rebate estimated upon the anticipated gallonage over the agreed trading period.

- My Lords, I am quite unable to accept these submissions. No one has suggested that the transaction of lease and sublease was a sham. It was a real transaction representing the realities of the situation, which, in this buyer's
- F market, some tough dealers were able to impose upon Regent in its anxiety to maintain, and no doubt if possible to expand, its sales of petrol in this country. Pausing there, I may add parenthetically that I cannot see any conceivable difference for any relevant purpose between an anxiety merely to preserve and maintain Regent's share of sales of petrol in this country and an anxiety to increase their sales if possible. It is all part of the fight to remain in the market.
- G These transactions were not a mere cloak for a trading operation. Of course, in a sense the whole operation was intended to promote trade, because Regent realised that exclusivity was the only way of remaining in the market and they must give a corresponding consideration to a dealer who was willing to buy exclusively the products of Regent for a period. So in the end both parties had their eyes solely upon trade. But that does not entitle the Court to disregard
- H the agreements that the parties have made with a view to carrying out their arrangements, and it is impossible to disregard the four leases and to dismiss them as a mere cloak. It was not merely a matter of form. These transactions were as a matter of substance and reality forced upon Regent to their regret by these few tough dealers as the price of the exclusive tie. It is therefore necessary to examine those transactions to see whether Regent is entitled to succeed in
- I its claim that these lump sum payments were in fact in the nature of a revenue expenditure, being really in the nature of rebates.

**(Lord Upjohn)**

My Lords, in the field of real property in relation to taxation certain matters are so fundamental as now to be axiomatic. Thus, in cases other than those where a man is a property dealer, so that property is his stock-in-trade, it is quite clear that the purchase of a fee simple for a purchase price by a trader is the acquisition of property for the purposes of trade and the purchase cannot be regarded as a cost of carrying on the trade; it is therefore capital. This is so, though the trader may desire to acquire the property for the purpose of providing himself with circulating capital by mining operations on the property acquired, even if he is intending to acquire the property only for a short time: see *Knight v. Calder Grove Estates* 35 T.C. 447. Exactly the same principle applies if the purchase price is payable by instalments spread over a period; it is a capital payment. But if the trader acquires a property on lease and pays a rent reserved by that lease that rent is not regarded as merely the acquisition of property *de die in diem* but as payment for the use of property, and the rent therefore is treated as a revenue expenditure and is deductible for purposes of tax. If in *Knight v. Calder Grove Estates* the trader had leased the property for a dead rent and royalty, that rent and royalty would have been deductible as a revenue outgoing. This is as well settled as anything in the law of taxation. But it frequently happens that the trader, anxious to acquire a leasehold property, has to pay a premium for the acquisition of a lease, or possibly on renewal of a lease on its expiry; there can be no difference between the two situations. In such a case it is quite clear that the payment of a premium is regarded as the cost of acquiring the property for the purposes of the trade and not as part of the carrying on of the trade, and hence the premium, although paid for a property of a wasting character, is capital. If authority for that elementary proposition is required, it is to be found in the Scottish case of *McTaggart v. Strump*<sup>(1)</sup> 10 T.C. 17. There is no magic in the use of the word "premium"; it merely means a lump sum paid as a consideration for the acquisition of the lease. And so also if the premium or lump sum is paid by instalments spread over the term of the lease it still remains of a capital nature; it may be very difficult as a practical matter in a particular case to ascertain whether, on the true construction of the document, such periodical payments are rent or payment of a lump sum by instalments, but once that question has been answered the distinction is clear. If it is a premium, that is to say, a lump sum payable by instalments, it is capital. If it is rent or a royalty it is an outgoing deductible for the purposes of tax.

My Lords, having stated those elementary propositions which it is not possible to doubt, then the problem in this case is clearly answered. It is plain that the premium or lump sum paid by Regent in order to acquire the lease is a lump sum payment for the acquisition of an asset for the purpose of carrying on a trade thereon and is therefore capital. With all respect to the argument that the three days' reversion gave to Regent only a nominal interest in the land which could really be ignored, this entirely overlooks the point that the nominal reversion (valueless, of course, as enjoyment of the land for three days) gave the most valuable advantage to Regent because the transaction made them the immediate lessor of the dealer. That fact gave Regent very substantial advantages, which it would not have acquired under the ordinary contract of the *Bolam*<sup>(2)</sup> type, though no doubt those advantages were, as a matter of finance, outweighed by the consideration that there was a grave risk that the premium might be considered to be capital and not deductible for the purposes of tax.

(<sup>1</sup>) 1925 S.C. 599. (<sup>2</sup>) 37 T.C. 56.

(Lord Upjohn)

- A The countervailing advantages were, of course, that Regent throughout the term of the lease was in a much better position to enforce the covenants in the lease than if the matter had merely rested in contract. For example, had the matter remained in contract, it might have been possible for a distributor to go out of business in breach of contract and to dispose of his garage to an innocent purchaser, and then Regent would be left with no more than a possibly arid claim for damages against the dealer. As a lessor under the lease Regent was under no such difficulty. Regent could at once re-enter, subject always to giving proper notices under s. 146 of the Law of Property Act 1925.

- My Lords, as I understand their judgments, Pennycuick J. and Dankwerts and Diplock L.JJ. reached the same conclusion solely on the ground that the premium was a lump sum payment for the acquisition of a lease. I do not think that Diplock L.J., [1964] 1 W.L.R., at page 1177<sup>(1)</sup>, was making any alternative finding. I think he was only criticising, and, if I may say so, rightly criticising, the mistaken findings of the Commissioners. Lord Denning M.R. decided the case on the same ground, but he also decided it on an alternative ground. He said, [1964] 1 W.L.R., at page 1174<sup>(2)</sup>, that even if one looked at the transaction in a business sense one gets the same result, and he then posed a case where
- D Regent said to the owner of the piece of land that they would pay £5,000 for the exclusive right to sell petrol for five or ten or 21 years. That payment, the Master of the Rolls thought, would be clearly capital and he thought it could make no difference if the payment was for exclusivity by the dealer. My Lords, in view of that statement and of the elaborate arguments that have been addressed to your Lordships, I propose now to examine the situation upon the
- E footing that there was no transaction of lease and sublease in these four cases, but they were ordinary trading contracts for the considerations and for the terms of years which I have set out earlier in this judgment, the dealer agreeing to buy all his petrol requirements during the terms from Regent and no other. Would such payments be lump sum payments of a capital nature, as the Master of the Rolls clearly thought they would be, or would they be trading expenses,
- F having regard to the custom of the trade to enter into these long-term contracts to preserve and maintain their trading position and to the fact that the lump sums were arithmetically calculated by reference to anticipated gallonage?

- I suppose that no part of our law of taxation presents such almost insoluble conundrums as the decision whether a receipt or outgoing is capital or income for tax purposes. Parliament, wisely, has never given any general statutory guidance in this matter. It has been content to leave the determination of these difficult matters to the common sense of the tribunals and Judges before whom these matters are brought.
- G

- Naturally, therefore, many judicial decisions were cited to your Lordships; so many of them so far removed from the facts of this case that I can gain no assistance from them and shall not discuss them, apart from three which I shall mention presently. I only desire to say that I regard the decision in *Henriksen v. Grafton Hotel Ltd.*<sup>(3)</sup> [1942] 2 K.B. 184 as a very special case, a decision which, if it can be supported at all, can be justified solely upon its own particular facts within the realm of licensing laws. Of the cases which I must discuss, the first in point of time is *Atherton v. British Insulated and Helsby Cables Ltd.*
- H

<sup>(1)</sup> See pages 20–21, *ante*.      <sup>(2)</sup> See page 18, *ante*.      <sup>(3)</sup> 24 T.C. 453.

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10 T.C. 155, where Viscount Cave L.C., at page 192, made his celebrated statement that, if an asset or an advantage is brought into existence for the enduring benefit of the trade, there is good reason to treat such an expenditure as attributable to capital. In many cases this will be a valuable criterion, but it does not help in this case, for it only invites the further question, how long does it take to be an "enduring benefit" if you are dealing with a purely long-term trading agreement? I am sure that Lord Cave, when he made these observations, did not have in mind anything in the nature of a long-term trading agreement. Therefore, I gain no real assistance from that case.

The next case in point of time is the Australian case of *Sun Newspapers Ltd. v. Federal Commissioner of Taxation* 61 C.L.R. 337, where Dixon J., sitting in the High Court of Australia, at pages 359 *et seq.*, had some very useful observations to make on this general question. That, however, was a very different case; the question there was whether a large sum paid out to stifle competition permanently was capital or income and it is not surprising that it was held to be capital, and I cannot for my part obtain much help from those observations in the very different circumstances of this case.

Finally, Lord Radcliffe in *Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.* [1964] A.C. 948, at page 960, selected as probably the most illuminating line of demarcation that between the cost of creating, acquiring or enlarging the permanent structure of which income was to be the fruit and the cost of earning that income itself. This brings me at once to the argument addressed to your Lordships on behalf of the Crown, when it was submitted that the contract for the exclusive supply of petrol for a term of years was a chose in action creating a right which, provided it lasted for more than an annual accounting period, was necessarily part of the permanent profit-making structure and therefore capital, while the exercise of the right thereby granted to supply petrol was part of the income-earning activities of Regent. When dealing with tangible assets, the distinction between the profit-earning structure and the cost of earning the income may not be difficult to draw. It becomes very difficult when dealing with a purely commercial contract, and I do not think it useful to endeavour to dissect such a contract in this manner for the purpose of tax; that is too artificial an operation and is divorced from the realities of the situation. I do not for one moment think that these long-term trading contracts can possibly be described as part of the profit-earning structure of Regent. But that does not mean that it necessarily follows that the lump sums paid under that contract are necessarily to be regarded as the expenses of carrying on the trade; it merely means that I do not think that the demarcation suggested by Lord Radcliffe in the *Nchanga* case is of assistance in the completely different circumstances of this case.

How, then, is this problem to be solved? My Lords, there is one matter upon which Counsel on both sides are agreed: that it is the duty of the Court to consider every relevant fact, giving it its due weight, and then to reach a conclusion upon the whole matter. I cannot but recall the observation of Sir Wilfrid Greene M.R. in *Commissioners of Inland Revenue v. British Salmson Aero Engines Ltd.* <sup>(1)</sup> [1938] 2 K.B. 482, at page 498, where he said:

"There have been many cases which fall on the borderline. Indeed, in many cases it is almost true to say that the spin of a coin would decide the matter almost as satisfactorily as an attempt to find reasons."

<sup>(1)</sup> 22 T.C. 29, at p. 43.

(Lord Upjohn)

A Somewhat cynical, but true. It is a question of fact and degree and above all judicial common sense in all the circumstances of the case, and, while no one regrets it more than I, I do not believe it is possible to lay down any principle, when dealing with trading contracts, which would be of any guidance alike to Crown and subject in future cases.

B I certainly approach the problem with this in mind, that in modern conditions trading contracts become more and more complicated, and those responsible for the affairs of large companies have to look much further into the future and to plan for the future in a way unthought of years ago. A company may reasonably require and be prepared to pay for secured outlets for its products for some years ahead, especially when dealing with a product like oil which costs so much to extract, transport and refine. Another company executing a long contract to supply a number of complicated machines, e.g., aeroplanes, may want to assure itself of a constant supply of some vital component and be prepared to pay some supplier a lump sum to assure that supply. Such payments are not lightly to be held to be capital. But the amount of the payment and the length of the tie are important elements among all the other relevant facts. I part company at once with the submissions of Counsel on both sides, D on the one hand, that a lump sum payment for a tie for more than an annual accounting period is necessarily capital and, on the other, that the length of the tie is utterly immaterial save as a factor in calculating the anticipated gallonage and so the amount of the lump sum payment. The lump sum payments here are large. But one must not attribute to that too much importance, because after all the lump sum payment is calculated on the basis that it represents no more than 1d. per gallon on the expected sales over the length of the tie. So I approach E this matter as one of judicial common sense and I start with the case of Murphy; it seems to me that to pay substantial sums for a tie for as long as 21 years is quite plainly, as a matter of common sense, a tie which must be described as of a capital nature, so that the sums paid under the Murphy agreements must be regarded as capital. So, too, must be the sum of £10,416 paid under the F agreement with the Stadium Motor Works, Belfast, for a tie of a similar length.

On the other hand, one has the agreement with C. V. Clapp Ltd. for a payment of a sum for five years. The sum, of course, is much less, as is the tie, but I would think the length of the tie plainly puts it into the character of a merely long-term trading contract, and this would have been an ordinary trading expense deductible for tax had it not been for the fact that the company was G able to drive a hard bargain with Regent to ensure that it was capital. The interesting case, of course, is that of Green Ace Motors, where the tie was for ten years for payment of a sum of £5,000. This is a borderline case, and I shall say no more about it than that I think it was very wise of that company also to drive a hard bargain with Regent which quite plainly made the sum a capital sum.

H I would dismiss these appeals.

**Lord Wilberforce**—My Lords, these appeals raise the question whether certain payments made by the Regent Oil Co. Ltd. to dealers in petroleum products were, for the purposes of income tax in the one case, and of profits tax in the other, of a capital or of a revenue character. The issue is the same as it relates to either tax. Moreover, although there are some differences of detail I as regards the individual payments, it is agreed that, with one exception, these are not significant. The payments were made under agreements which typically

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provided for (a) a lease of a filling station site by the site owner to Regent for a nominal rent but in consideration of a sum or premium, (b) a sublease granted on the same day by Regent to the site owner for the whole term of the lease less a few days, (c) covenants contained in the sublease on the part of the site owner to take the whole of his requirements of petroleum from Regent during the term of the sublease, (d) provisions enabling Regent to enforce these covenants by re-entry and restricting the right of the site owner to part with his garage without ensuring that the assignee was bound by the covenants. Finally, (e) the sum paid for the lease was calculated by reference to the amount of petrol expected to be sold at the station over the period of the lease—at so much per gallon—with, in certain cases, provision for an extra payment if more than this was sold. There was to be no reduction in the sum if less was sold, but in one case the lease, in that event, was to be extended.

The possibly significant difference between the agreements lies in the length of the term of the lease. In most cases this was for 21 years, but in one case the term was ten years and in another five years. It is the nature of the sum or premium (the name does not matter) paid for the lease that is in question, Regent seeking to establish that this is revenue expenditure and so deductible before arriving at net or taxable profits.

The nature, capital or revenue, of the expenditure is primarily to be determined from a consideration of the transactions in respect of which it was made, but it is right to look at these against the general commercial background of Regent's trading business. These are explained in considerable detail in the Case Stated. The general features of the "exclusivity war" which developed in the early part of the decade 1950–60 between the major oil companies are by now well known. The lease-sublease transaction was a stage in the intense competition to gain or maintain retail outlets, which put retailers in the position of being able to demand from the companies payments or concessions of varying kinds as the price of tying their sites to a single supplier; in the particular case of Regent it represented a development from the granting of rebates—first paid periodically and later in lump sums—which during the relevant years continued to constitute the majority of the payments agreed to. Some of these arrangements were considered in the case of *Bolam v. Regent Oil Co. Ltd.* 37 T.C. 56 and there held to be revenue payments. In 1957–58, the first of the years whose income tax assessment is now under appeal, of the 4,886 stations at which Regent's oil was sold, 4,483 (i.e., 91·7 per cent.) were tied stations, and of these only twelve were tied by the lease-sublease method. The sums paid, though in themselves considerable, were not large in relation to the total expenditure of Regent in securing solus sites, at any rate were not so large that the amount of them could support a suggestion that they exceeded normal revenue expenditure.

In the course of the numerous decisions which have distinguished between capital and revenue expenditure in relation to widely different trades and varying circumstances, certain "tests" have emerged. These may be useful, so long as it is recognised that they have emerged *a posteriori* from the facts of a given situation and that they may not always be suitable as guiding lines in other situations. I begin by asking two questions, which may be said to be generally relevant: What is the nature of the payment, and for what was the payment made? These, together with a third question, namely, how that for which the payment was made was to be used, were stated by Dixon J. in his classic judgment in *Sun Newspapers Ltd. v. Federal Commissioner of Taxation* 61 C.L.R. 337.



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A There are, he said, at page 363:

“three matters to be considered, (a) the character of the advantage sought, and in this its lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and (c) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.”

I may add to this another statement by the same learned Judge in the later case of *Hallstrom's Pty. Ltd. v. Federal Commissioner of Taxation* 72 C.L.R. 634, at page 648:

C “What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process.”

I start, then, with a consideration of the nature of the relevant payments made by Regent in the light of the criteria stated by Dixon J. under paragraph (c). This formulation is useful in pointing the distinction (as to which much discussion arose in the argument) between a premium paid for a lease, which produces an asset for future use, and rent paid under a lease which is for current use; the first being a capital and the latter a revenue payment. I find it helpful here. The distinction is clear and intelligible, and though a complication may arise where a premium or payment for an asset is made payable periodically by instalments or when a single payment is made which is, or is described as, of rent in advance, that need not concern us here, for the payments were neither described as, nor were they, of this latter nature. They were lump sums paid at the start of the transactions to procure the immediate emergence of an asset or advantage, enjoyment of which was secured for a period. They were not, and did not represent the aggregation of, current payments made for the day-to-day use of or continuation of an advantage. They appear at first sight to bear the character of capital payments for an asset.

The Appellants bring forward two arguments at this stage. First, they say (truly enough) that the sums or premia were calculated by reference to the gallonage of petrol expected to be sold at the sites, the suggestion being that this made them resemble, or be, rebates on the price. An effective answer to this was given in the Court of Appeal, where Lord Denning M.R. said that it confuses the measure of the payment with the payment itself. A more elaborate form of the argument was that the sums were calculating capital because Regent expected to get its money back out of current profits as sales, gallon by gallon, day by day, were made. Of course they did; many traders who lay out capital expect to get both a return on the capital and the amortisation of the capital expenditure out of the profits of the periodical sales, and, whether consciously or not, they calculate the amount they are willing to lay out accordingly; but the fact that they have this expectation and so calculate their expenditure does not enable them to claim that the expenditure is of a revenue character.

Then it was said that the payment, though in a sense of a “once for all” nature (in that it was a single payment for a particular advantage), was really of a recurrent character because the necessity was evident (though the evidence

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is not very apparent in the case of a 21-year lease) that as the leases expired they would have to be renewed and fresh expenditure of the same kind incurred. Sometimes an argument of this kind may have some force: for example, in the *Vallambrosa Rubber Co. Ltd. v. Farmer* 5 T.C. 529 the expenditure, though described by Lord President Dunedin as "once for all", was accepted as revenue expenditure because it related to a subject matter, namely, weeding, which in its nature "does occur every year", or in *Rhodesia Railways v. Income Tax Collector, Bechuanaland* [1933] A.C. 368 where the expenditure related to the obviously continuous matter of repairs. Conversely, in other cases, the argument fails because the expenditure is clearly capital in character—as, for example, when it is on plant such as the knives in *Hinton v. Maden & Ireland Ltd.* 38 T.C. 391—and mere repetition of capital expenditure cannot turn it into revenue expenditure.

There may be an intermediate situation in which the nature of the expenditure is not clear, or near the borderline, or where the possibility of recurrence may tip the scales; whether this is such a case must await an appraisal of the other factors. Subject only to this point, in my opinion at this stage the character of the payment points to capital.

Next, as regards the nature of the asset or advantage gained. There are possibly two ways of regarding this. The first is to treat the payment as made for a lease of from five years to 21 years, i.e., for a legal estate in land; the second, which I prefer, and which fits more closely to what Dixon J. said in the *Hallstrom* case<sup>(1)</sup>, is to treat it as made for the granting of a lease which was (as part of the single bargain) to be subject to a sublease containing an exclusivity covenant by the sublessee with provisions making that covenant effective. So regarded, the payment was for a solid recognisable asset, evidently (to my mind) of a capital nature. It was transferable, in a limited market no doubt, but in that market it was valuable; it was a source or foundation for the earning of profits, through orders for petrol to be placed under it; it can fairly be described as a piece of fixed capital which is to be used in order to dispose of circulating capital.

I find of assistance here the case of *Commissioners of Inland Revenue v. Coia* (1959) 38 T.C. 334, where a payment was made for a tie (by way of personal covenant) for ten years. The Court of Session held that this payment was capital in the hands of the recipient. Lord Patrick said, at page 339:

"he parted with what I regard as a valuable asset of a capital nature, the right to obtain the supplies of fuel oils which were his stock-in-trade from such sources as he might consider most suited to the varying nature of the demands made by his customers",

and he held that the transaction should be entered in a capital and not in a profit and loss account. The character of a payment in the recipient's hands may differ from that which it bears to the maker of the payment, but here it seems to follow naturally and logically that the valuable asset given up by the garage owner was acquired by the supplier and so acquired as a capital asset. The addition in the present case of the lease-sublease transaction does nothing to weaken the force of this argument.

On behalf of the Appellant it was said that we must look through the transparent form of the lease-sublease to some underlying commercial reality

<sup>(1)</sup> 72 C.L.R. 634, at p. 648.

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- A and that, having performed this penetration, we should see that this was merely part of Regent's normal marketing operations, or, alternatively, that the payments were nothing but disguised rebates. I cannot accede to this. Without embarking here upon the question how far it is permissible in taxation matters to go behind the legal forms which the parties have chosen, where these forms are not a mere sham, I am satisfied that in this case form and substance fully coincide. The garage owners, so the Commissioners find, desired (possibly for fiscal reasons of their own) to use the particular method of lease and sublease, and Regent agreed with it; the transaction, in this form, was neither a sham nor commercially unreal; it secured for the site owner a lump sum payment and it gave to Regent the tie which it desired, buttressed and given efficacy by the privity of estate which the lease-sublease created.
- B
- C This brings me to consideration of the durability of the advantage acquired. As Dixon J. said<sup>(1)</sup>, when considering the nature of the advantage sought, "its lasting qualities may play a part". In English law the term most commonly employed in this part of the argument is "enduring"—ever since Viscount Cave L.C. in the *British Insulated and Helsby Cables Ltd. v. Atherton*<sup>(2)</sup> [1926] A.C. 205, at page 213, spoke, without intending to lay down a test, of "the enduring benefit of a trade". It might be enough to decide this case in favour of the Crown to say that, in relation to an "asset" of so concrete a character as a lease, or as a lease accompanied by a sublease, at any rate when the term of the lease amounts to five years or more, the test of durability is satisfied, but I do not wish to rest on this narrow ground; indeed, I do not think that it is sound reasoning to do so. I agree entirely with Lord Denning M.R. that if one considers the business reality here, or, in the words of Dixon J., what the expenditure is calculated to effect from a practical and business point of view, the payments were made for rights (reinforced by the lease-sublease method) of exclusive supply of petrol to certain filling stations for periods varying from five years to 21 years. It is the durability of this complex right which has to be considered, and we must squarely face the question whether such an advantage is sufficiently enduring in the context of Regent's trade to qualify as a capital asset, or whether it has such transient qualities that it ought properly to be regarded as "day-to-day" or "current", and so revenue expenditure. It seems to me an undue abstraction to segregate the leasehold or real element in this complex and to apply to it a special rule or test which may exist in relation to such assets in other contexts; and, relevant, no doubt, though the lease-sublease framework is, it requires to be demonstrated that a different durability test is to be applied in cases where that framework exists and in cases where the advantage consists of a simple tie unsupported by it. The commercial reality is substantially the same, for it is not suggested that Regent paid any more in the lease-sublease cases than in those cases where there was a simple tie, or that Regent had any desire for the lease-sublease method; on the contrary, the evidence is that Regent disliked it and that the retailers forced it on Regent.
- D
- E
- F
- G
- H Surely, therefore, the test should be identical.

Is there, then, any line which can be drawn below which expenditure for a short-term asset has, or can have, a revenue character? It is noticeable, and I think significant, that, with one possible exception, there is no authority in favour of the view that, though an advantage has been identified, expenditure to gain it should be treated as revenue expenditure because of the short-term

<sup>(1)</sup> 61 C.L.R. 337, at p. 363.      <sup>(2)</sup> 10 T.C. 155, at p. 192.

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character of the asset. That one possible exception is *Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.* [1964] A.C. 948, where the agreement was for the period of a year. Although there were other, possibly more important, considerations which led the Judicial Committee to consider the payment as having a revenue character, the contrast was pointed out between the payment in question, which exhausted itself and was created to exhaust itself within the twelve months' period "within which profits were ascertained", and a "contractual right to last for years", payment for which may be capital expenditure. Some other cases on short-term assets are of interest. *McTaggart v. Strump* 10 T.C. 17 was a case of a premium paid for renewal of a lease for five years—this was held a capital expense—which the trader would probably make good out of his profits when earned. *Commissioners of Inland Revenue v. Adam* 14 T.C. 34 was concerned with a right for eight years to deposit earth and slag on another's land; the right was held to be a capital asset, Lord President Clyde considering it as equivalent to any other capital asset of a "relatively permanent character". *John Smith & Son v. Moore*<sup>(1)</sup> [1921] 2 A.C. 13 is a delusive case; it appears to involve precisely the critical area which we must consider here—namely, very short-term contracts—but no clear conclusions can be drawn from the decision. The difficulties inherent in it have been so fully analysed by the Judicial Committee in the *Nchanga* case and by others of your Lordships that I shall not take up time by a further discussion of them. More comprehensible is *Henriksen v. Grafton Hotel Ltd.* 24 T.C. 453, where it was held in the Court of Appeal that a payment in respect of so-called monopoly value on the renewal for three years of a licence was a capital payment. The subject-matter of the payment there, though of a special character (but what asset is not?), was in the same area as the ties in the present case, and Lord Greene M.R. said<sup>(2)</sup>:

"The thing that is paid for is of a permanent quality although its permanence, being conditioned by the length of the term, is short-lived"; and he regarded the fact that the licence had to be renewed every three years as irrelevant—there was "a false appearance of periodicity" about them. Lastly, there are certain cases concerned with opencast mining: *Knight v. Calder Grove Estates* 35 T.C. 447; *Stow Bardolph Gravel Co. Ltd. v. Poole*<sup>(3)</sup> 35 T.C. 459; *H. J. Rorke Ltd. v. Commissioners of Inland Revenue* 39 T.C. 194. In two of them the question of transience was raised, and in each it was decided that, once the conclusion was reached, on other considerations (the validity of which need not be here considered), that the asset acquired was fixed and not circulating capital, the fact that the asset was of a transient character is irrelevant. These authorities do little more than provide illustrations of the character of various types of assets in various trades. The principle seems to emerge that if, on a consideration of the nature of the asset in the context of the trade in question, it is seen to be appropriate to classify it as fixed rather than as circulating capital, the brevity of its life is an irrelevant circumstance. But it would still be correct, in my opinion, where the nature of the asset, taken together with other relevant factors, leaves the matter in doubt, to have regard, amongst other things, to its transient character. No rule can be laid down as to a minimum period of endurance for a capital asset or a maximum permissible period for an item of stock or circulating capital, though obviously the more closely the period of endurance is related to an accounting period the easier it is to argue for a

<sup>(1)</sup> 12 T.C. 266.    <sup>(2)</sup> 24 T.C., at p. 459.    <sup>(3)</sup> [1954] 1 W.L.R. 1503.

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A revenue character, but no doubt there is a penumbra the width of which may vary according to the nature of the trade.

I return, then, to the expenditure in this case. Here the nature of the payments—lump sums, the nature of the advantages obtained—security in respect of the placing of orders for a period, the substantial periods involved, the shortest being a period of five years, more than adequately establish the expenditure as made for the acquisition of capital assets. Conversely I can see no basis upon which such assets can be given such a character that payments for them can be treated as revenue payments, whether as stock or as circulating capital or by any other description. To say, as the Company does, that it has become the custom of the trade to make them, appears to me as indecisive as to say that the vast size of modern industrial enterprises, and particularly of oil companies, forces them to engage in long-term contracts. All this may be true, but it is still necessary to look at the actual means adopted to conform with the custom or to secure the long-term trading advantages before it is possible to attribute a capital or a revenue character to the payments. The two obvious alternatives are to offer rebates as orders are given or to offer lump sums in exchange for security for a period; the one—like rent—qualifies as revenue, the other—like a premium—as capital. As to the critical period, I can see no logical basis for saying, for example, that 21 or ten years is good enough but five or three years is too short, or for saying that five years or three years may be long enough when there is a lease and not long enough where there is merely a personal covenant, and there is nothing in the evidence in this particular case to justify these distinctions. Nor is there any factor here which enables me to relate any of the payments to an accounting period, however flexibly that criterion be applied.

I must, however, say something of *Bolam v. Regent Oil Co. Ltd.*<sup>(1)</sup>, which was concerned with ties varying from six months to six years. The decision was not the subject of an appeal, and Counsel for the Crown did not seek to attack it. But he made it plain that his acceptance of it was upon the basis that it can and should be regarded as a case of a current payment, through rebates or compounded rebates, for current enjoyment of the advantage conferred by the ties. I think that Danckwerts J., so regarded it, both when he decided the case—for he made the comparison with rent—and also in the appeal in the present case. So regarded, it falls well within the alternative formula in *Hallstrom's case*<sup>(2)</sup>, and I fully accept it. If it is sought to use it as authority of general application in the trade that payments for ties of six years or lesser periods are revenue payments, I cannot agree with it.

There is one other argument on which some observation is necessary, namely, that based on accountancy considerations. It was argued, generally, that an asset of this kind—a short-term advantage—ought more appropriately to appear in the profit and loss account than in the balance sheet. This is, in part, to beg the question, but it may be useful to use this way of stating the issue as a cross check. So doing, I know of no reason why a short-term lease, for which a sum has been paid, or the benefit of a short-term covenant, should not rank as a capital asset. Of course, its value ought in prudence to be written off over its life out of revenue, and it is no doubt fiscally unpleasant for the trader that (the income tax code allowing no depreciation of such assets to be charged) he must do so out of taxed income. But this tax disadvantage cannot

(<sup>1</sup>) 37 T.C. 56.      (<sup>2</sup>) 72 C.L.R. 634.

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be used as an argument against the insertion of the item in the balance sheet rather than the profit and loss account; it is merely an argument against resorting to this type of transaction. A

Even if the trader prefers for reasons of his own to charge the cost of a short-term asset wholly against the revenue of the year of acquisition, that decision cannot affect his liability for tax. Then, more particularly, it was said that accountancy evidence given in this actual case supported the charge against revenue. But all that the Commissioners say is this: B

“Auditors and accountancy advisers of Regent who gave evidence before us took the view that such payments were made to preserve turnover, that no fresh asset was acquired as a result of such payment and that accordingly such payments were properly chargeable to revenue.”

This is either irrelevant or wrong: it is irrelevant that the expenditure was made to preserve rather than to create turnover; wrong to say that no fresh asset was created; the contrary is clearly the case: this evidence does not deal with the question of transience at all. So I cannot obtain any guidance from accountancy considerations. C

I would add that in *Bolam's* case<sup>(1)</sup> also some reliance was placed on accountancy evidence, but that evidence was inconclusive and, as I read the judgment of Danckwerts J., he did not rely on it. D

I come, therefore, to the conclusion that the indications derived from the nature of the payment, the commercial and legal nature of the advantage gained, and the use to be made of the advantage, all point in the direction of capital, and that they do so with a clarity which is more than sufficient to countervail such slight indication in favour of revenue (and I repeat that in this case the indication is slight) as is to be derived from the possible recurrence of the expenditure. E

I would dismiss the appeals.

*Questions put:*

That the Orders appealed from be reversed.

*The Not Contents have it.*

That the Orders appealed from be affirmed and the appeals dismissed with costs. F

*The Contents have it.*

[Solicitors:—Solicitor of Inland Revenue: J. G. Senior.]

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<sup>(1)</sup> 37 T.C. 56.